



GOVERNOR'S COMMITTEE

on Simple, Fair and Low Taxes

GOVERNOR'S COMMITTEE ON SIMPLE, FAIR AND LOW TAXES

TAX POLICY AND TAX CREDIT REFORM: RECOMMENDATIONS TO MAKE MISSOURI A BEST-IN-CLASS STATE

June 30, 2017

Executive Summary

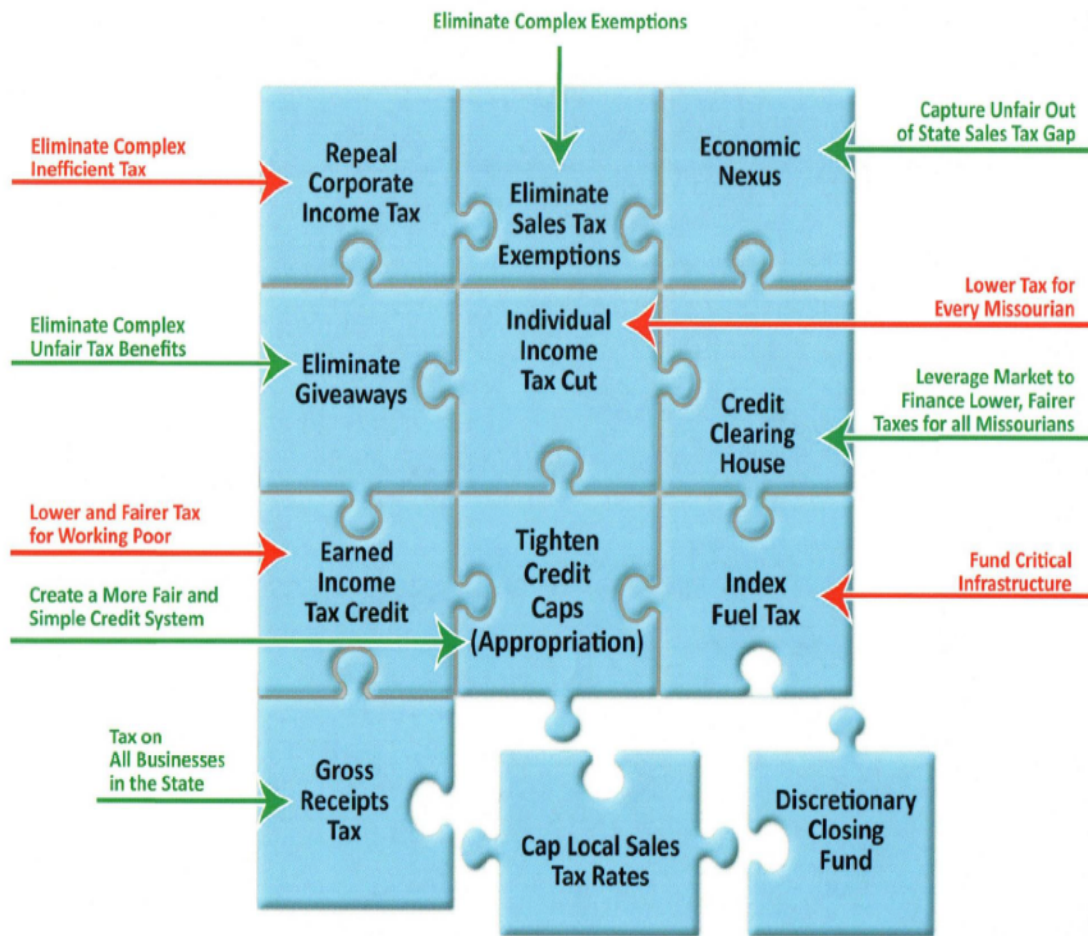


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I. BACKGROUND AND OVERVIEW

On January 25, 2017, Governor Eric Greitens created the Governor's Committee on Simple, Fair and Low Taxes (the "Committee") to evaluate Missouri's tax policies and tax credit programs and provide detailed recommendations for reform.¹ Governor Greitens charged the Committee with four main goals: (1) compare Missouri's tax credit programs and its tax rates to those of peer states; (2) assess the economic impact of existing State tax credit programs; (3) assess the possibility of financing cuts to overall State tax rates with cuts to tax credit programs; and (4) recommend comprehensive tax reform legislation to the Governor no later than June 30, 2017.²

The Committee was composed of the following ten members:

- Joel Walters, Director of the Missouri Department of Revenue (Chairman)
- Will Scharf, Policy Director for Governor Greitens (Vice-Chairman)
- Hon. Dan Hegeman, State Senator
- Hon. Andrew Koenig, State Senator
- Hon. Will Kraus, State Senator
- Hon. Jay Barnes, State Representative
- Hon. Elijah Haahr, State Representative
- Hon. Holly Rehder, State Representative
- Jason Crowell, former State Senator
- John Lamping, former State Senator

On March 10, 2017, the Committee created three subcommittees to address core sections of tax and economic incentive policy:

- (1) Income Tax Policy Subcommittee:
 - Hon. Andrew Koenig, State Senator
 - Hon. Elijah Haahr, State Representative
 - John Lamping, former State Senator
- (2) Consumption Tax Policy Subcommittee:
 - Will Scharf, Policy Director for Governor Greitens
 - Hon. Will Kraus, State Senator
 - Hon. Jay Barnes, State Representative
- (3) Tax Credits and Incentives Subcommittee:
 - Hon. Dan Hegeman, State Senator
 - Hon. Andrew Koenig, State Senator

¹ Exec. Order No. 17-07 (2017), <http://www.sos.mo.gov/CMSImages/Library/Reference/Orders/2017/17-07.pdf> [hereinafter Exec. Order No. 17-07].

² Exec. Order No. 17-07 (2017), <http://www.sos.mo.gov/CMSImages/Library/Reference/Orders/2017/17-07.pdf> [hereinafter Exec. Order No. 17-07].

- Hon. Holly Rehder, State Representative
- Jason Crowell, form State Senator

A. Guiding Principles

The Committee adopted six core principles to guide its recommendations:

- (1) **Simple.** Too often, tax policies are complex and difficult to navigate. Compliance costs from unduly complicated taxes divert resources from more productive uses. Increasingly, companies are forced to hire a multitude of accountants and lawyers to ensure adherence to tax law. These massive compliance expenditures reduce the funds available for productive investment. Furthermore, they act as a barrier to entry by driving out new entrants and depressing small business creation.³ To combat problems stemming from unnecessary complexity, the Committee aimed to make its recommendations as simple as practicable.
- (2) **Fair.** Simply put, taxpayers in similar situations should be treated the same.⁴
- (3) **Low.** As stated in the Governor’s Executive Order creating the Committee, “Missourians should pay no more in taxes than absolutely necessary to fund the essential services of state government”.⁵ High taxes can harm families and businesses alike. For example, high taxes may deter job-creating business activity, robbing taxpayers of crucial opportunities to earn a living and provide for their families. The Committee’s recommendations are tailored to fund Missouri’s essential services while encouraging prosperity for all Missourians.
- (4) **Efficient.** Taxpayers deserve policies that encourage and reward positive choices. Too often, tax policies cause individuals and businesses to make decisions for reasons that have little to do with fundamental economic realities.⁶ Tax policies should be designed to discourage wasteful expenditure and encourage job creation and community investment.
- (5) **Transparent.** Taxpayers should be able to tell where the State’s revenue comes from and where it goes. Hidden taxes and incentives embodied in complex statutes and sweetheart deals with lobbyists conceal the cost of government and empower lobbyists to tilt the tax code in their favor. Tax policies should be clear and transparent to help taxpayers hold their government accountable.⁷

³ *A Guide to Tax Reform in Missouri: Report for the Governor’s Committee for Simple, Fair, and Low Taxes*, Governor’s Committee for Simple, Fair and Low Taxes (May 1, 2017) (statement of Aaron Hedlund, professor at University of Missouri) [hereinafter Hedlund].

⁴ *A Guide to Tax Reform in Missouri: Report for the Governor’s Committee for Simple, Fair, and Low Taxes*, Governor’s Committee for Simple, Fair and Low Taxes (May 1, 2017) (statement of Aaron Hedlund, professor at University of Missouri) [hereinafter Hedlund].

⁵ See Exec. Order No. 17-07.

⁶ See Exec. Order No. 17-07.

⁷ See, e.g., Testimony of Missouri Association of CPAs at Committee Hearing (May 15, 2017); see also *State Business Tax Reform: Presentation to Missouri Governor’s Committee for Simple, Fair and Low Taxes*, Governor’s Committee for Simple, Fair and Low Taxes (May 15, 2017) [hereinafter Cline].

- (6) **Stable/Predictable.** A sound tax system should be stable and predictable. Many business investments in communities take several years, and reliable tax forecasting is crucial to encourage long-term job creation and community development. For specific taxes, predictability means a stable rate structure and tax base. Additionally, Missouri is required to balance its budget every year, and unexpectedly low tax revenues can result in painful budget shortfalls.⁸

B. The Committee's Process

Following its inception, the Committee invited subject matter experts and members of the public to share their insight at public hearings, town hall meetings, and via written comment.⁹ The Committee's town hall meetings in Maryville, Hannibal, Cape Girardeau, and Springfield ensured that Missourians throughout the State had input in the Committee's recommendations for Missouri's tax environment and tax credit programs.¹⁰

The Committee received testimonies at its public hearings from the following subject matter experts:

- Todd Iveson, Missouri Department of Revenue, Director of Taxation Division
- Sallie Hemenway, Missouri Department of Economic Development, Director of Business and Community Services Division
- Mike Downing, Missouri Department of Economic Development, Acting Director
- Randy Hilger, Missouri Study Commission on State Tax Policy, Chairman
- Jared Walczak, Tax Foundation, Policy Analyst
- Douglas L. Lindholm, Council on State Taxation (COST), President & Executive Director
- Jeanette Mott Oxford, Empower Missouri, Executive Director
- Dan White, H&R Block, Director, Finance and Assistant Treasurer
- Nancy McLernon, Organization for International Investment, President and CEO
- John Lindbloom, American Institute of CPAs
- Robert Cline, Former OECD Senior Advisor, State Tax Policy Consultant
- Aaron Hedlund, University of Missouri Department of Economics, Assistant Professor of Economics
- Brian Smith, EY, Principal – Central Region Credits & Incentives Leader
- Emily Howell, EY, Senior Manager – Missouri Credits & Incentives Leader
- Joseph Christofanelli, EY, Senior Manager – Indirect Tax
- Dylan Grundman, Institute on Taxation and Economic Policy, Fiscal Policy Analyst
- Rod Chapel, Missouri NAACP, President

⁸ See Hedlund, *supra* Note 1

⁹ See *Open Meeting Notices*, OFFICIAL MISSOURI STATE WEBSITE, <https://www.mo.gov/meetings/> (last visited June 12, 2017); see also Press Release, Office of Missouri Governor Eric Greitens, Governor's Committee on Simple, Fair and Low Taxes Town Hall Meetings Schedule (May 10, 2017), <https://governor.mo.gov/news/archive/advisory-governor%E2%80%99s-committee-simple-fair-and-low-taxes-town-hall-meetings-schedule>; see also Press Release, Office of Missouri Governor Eric Greitens, Governor's Committee for Simple, Fair and Low Taxes Request for Public Comments (April 18, 2017), <https://governor.mo.gov/news/archive/governor%E2%80%99s-committee-simple-fair-and-low-taxes-request-public-comments>.

¹⁰ Press Release, Office of Missouri Governor Eric Greitens, Governor's Committee on Simple, Fair and Low Taxes Town Hall Meetings Schedule (May 10, 2017), <https://governor.mo.gov/news/archive/advisory-governor%E2%80%99s-committee-simple-fair-and-low-taxes-town-hall-meetings-schedule>.

- Patrick McKenna, Missouri Department of Transportation, Director
- Steven Stogel, DFC Group, Inc., President; Co-Chair of the 2010 Missouri Tax Credit Review Commission
- Charles Gross, Former State Senator; Co-Chair of the 2010 Missouri Tax Credit Review Commission
- Mark Gardner, Gardner Capital, Chairman
- John Cook, Gardner Capital, Executive Vice President of Investments
- Stephen Acree, RISE, Executive Director and President
- Kelly Forck, Missouri Department of Agriculture
- William F. Fox, The University of Tennessee-Knoxville Boyd Center for Business and Economic Research, Director
- Peter J. Czajkowski, Stifel, Nicolaus & Company, Director of Public Finance
- Gina Martin, Stifel, Nicolaus & Company, Director

C. Missouri's Current Tax Landscape

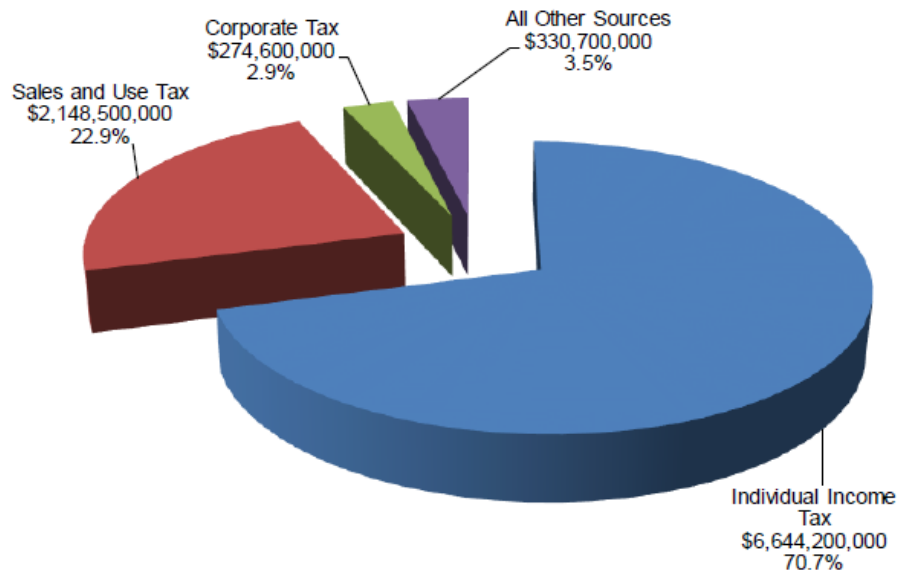
Missouri collects the bulk of its general revenue from the individual income tax (projected to comprise 70.7% of Missouri FY 2018 revenue), followed by sales and use tax (projected to comprise 22.9% of Missouri FY 2018 revenue) and corporate income tax (projected to comprise 2.9% of Missouri FY 2018 revenue) (see Figure 1 below). The Committee believes that Missouri has a real opportunity to improve its overall tax environment and compete nationally for economic growth and job creation.

Figure 1: Estimated Missouri Revenue (FY 2018)¹¹

¹¹ OFFICE OF ADMINISTRATION, DIVISION OF BUDGET & PLANNING, THE MISSOURI BUDGET FISCAL YEAR 2018 SUMMARY AT 8
https://oa.mo.gov/sites/default/files/FY_2018_Budget_Summary.pdf [hereinafter MISSOURI BUDGET FISCAL YEAR 2018 SUMMARY] (last visited June 12, 2017).

FY 2018 REVENUE ESTIMATE

Net General Revenue \$9,398,000,000



Missouri is sometimes referred to as a low tax state.¹² According to the Federation of Tax Administrators, Missouri has one of the lowest overall state tax burdens in the country, ranking 45th per capita and 44th as a percentage of personal income.¹³ According to the Tax Foundation, Missouri has the 15th best business tax climate in the U.S., ranking 5th for corporate income tax, 28th for individual income tax, and 24th for sales tax.¹⁴ Notably, the majority of the states ranked ahead of Missouri do not impose one of those major tax types.¹⁵

But considering its overall tax burden, Missouri typically falls in the middle of the pack, not particularly high or low. For example, Missouri's tax rates falls directly in the middle amongst states that levy

¹² FEDERATION OF TAX ADMINISTRATORS, 2016 STATE REVENUES PER CAPITA & PERCENTAGE OF PERSONAL INCOME, <https://www.taxadmin.org/2016-state-tax-revenue> (last visited July 13, 2017) [hereinafter *2016 State Revenues Per Capita*].

¹³ FEDERATION OF TAX ADMINISTRATORS, 2016 STATE REVENUES PER CAPITA & PERCENTAGE OF PERSONAL INCOME, <https://www.taxadmin.org/2016-state-tax-revenue> (last visited July 13, 2017) [hereinafter *2016 State Revenues Per Capita*]. Missouri ranks are similar when state and local tax burden are combined. Missouri ranks 46th per capita and 48th as a percentage of personal income.

¹⁴ Jared Walczak et al, *2017 State Business Tax Climate Index*, TAX FOUNDATION (Sept. 28 2016), <https://taxfoundation.org/2017-state-business-tax-climate-index>.

¹⁵ Jared Walczak et al, *2017 State Business Tax Climate Index*, TAX FOUNDATION (Sept. 28 2016), <https://taxfoundation.org/2017-state-business-tax-climate-index>.

an individual income tax - 19 have a higher top tax rate and 19 have a lower top tax rate.¹⁶ As a percentage of income, Missouri has a higher effective tax burden for many families. According to Professor Hedlund of the University of Missouri Department of Economics, a family earning \$50,000 per year faces a total tax burden of 10.3% in Kansas City, compared to 8.7% in Indianapolis and 6.9% in Denver.¹⁷ Additionally, a family earning \$75,000 faces a higher total tax burden in Missouri than in most other states (see Figure 2 below).

1. *Constitutional Challenges*

The Committee aimed to produce a bold tax policy proposal capable of enhancing Missouri's competitive business environment compared to other states. However, any recommendations must reflect reality, and Missouri has several important limitations that require consideration. As the Committee developed its recommendations in this report, it accounted for both State Constitutional and budgetary limitations to Missouri's tax landscape.

a. **Hancock Amendment**

In 1980, Missouri's Constitution was amended to add Article X, Sections 16-24, commonly referred to as the Hancock Amendment (the "Hancock Amendment"). The Hancock Amendment restricts the amount of personal income that can be used to fund state government. No more than 5.6% of taxpayers' personal income can be used to fund state government unless the revenue increase is approved by a vote of the people; in 2016, Missouri was \$4.1 billion under that threshold.¹⁸ Section 18 of Article X also places a monetary cap on the amount of new annual revenues that the General Assembly may produce without a vote of the people.¹⁹ For FY 2017, the threshold for new annual revenues would be an increase of \$101.5 million.²⁰

b. **Amendment 4**

In November 2016, Missourians voted to add Article X, Section 26 to Missouri's Constitution, which was known as Amendment 4 on the November 2016 ballot ("Amendment 4").²¹ Amendment 4 prohibits the imposition of sales, use, or similar transaction-based taxes on any service or transaction that was not subject to such taxes on January 1, 2015.²² As the U.S. economy becomes more service-centric, Amendment 4's full impact remains to be seen.

¹⁶ Jared Walczak et al, *2017 State Business Tax Climate Index*, TAX FOUNDATION (Sept. 28 2016), <https://taxfoundation.org/2017-state-business-tax-climate-index>.

¹⁷ Hedlund, *supra* note 18; see also Figure 3 below.

¹⁸ See MO. CONST. ART. X, § 18; see also Missouri Auditor, *Administration, Review of Article X Sections 16 through 24, Constitution of Missouri, Year Ended June 30, 2016* (May 2017) (page 1), available at <https://app.auditor.mo.gov/AuditReports/CitzSummary.aspx?id=567>.

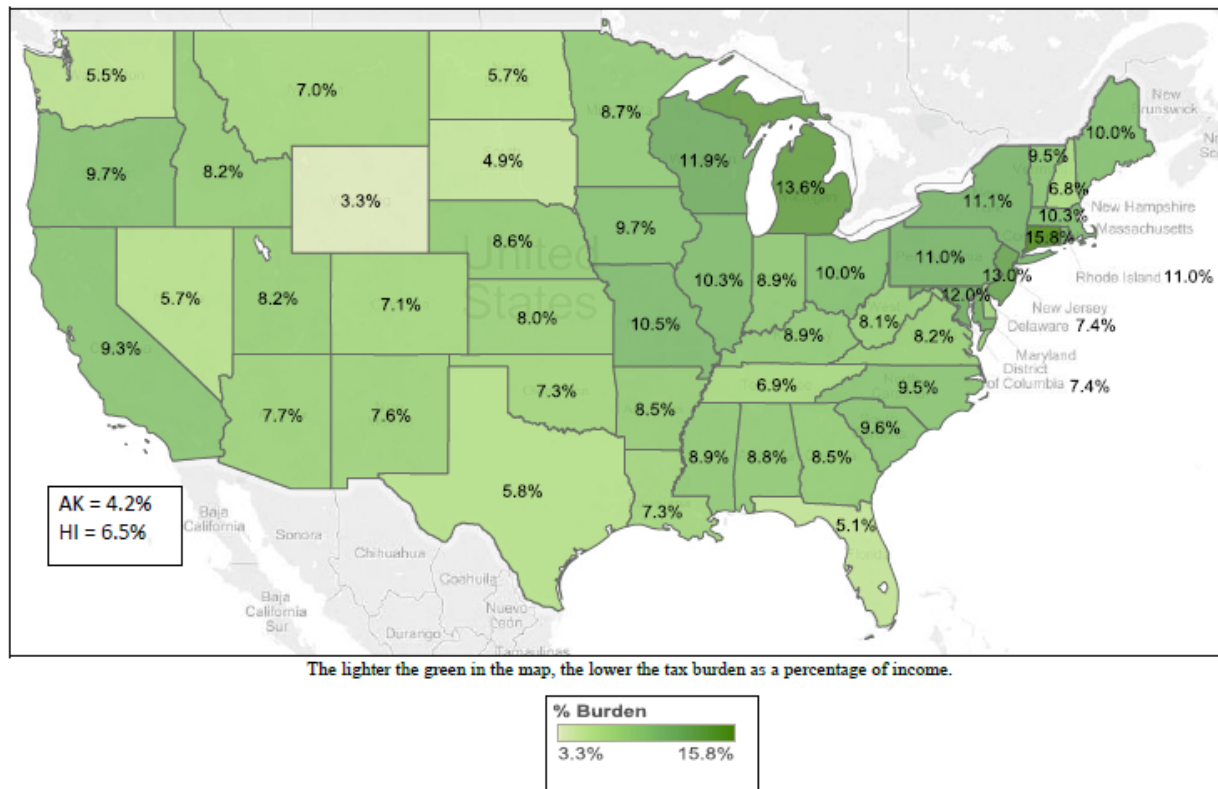
¹⁹ MO. CONST. ART. X, § 18.1

²⁰ See MISSOURI BUDGET FISCAL YEAR 2018 SUMMARY, *supra* note 55.

²¹ *State of Missouri General Election Results*, MISSOURI SECRETARY OF STATE, <http://enr.sos.mo.gov/> (last visited June 12, 2017).

²² See MO. CONST. ART. X, § 26.

Figure 2: 2014 Total State Tax Burdens (Income, Sales, Property, and Auto) as a Percentage of Income for a Family Earning \$75,000/year²³



c. Budgetary Constraints

Recommendations for Missouri's tax policy must be considered in the context of short-term budgetary challenges. Missouri has experienced a recent plague of budget shortfalls, including a deficit of over \$500 million awaiting Governor Greitens upon his inauguration.²⁴ Budget deficits have led to constant funding battles for critical State functions such as education and infrastructure. According to the Missouri Budget Project, Missouri's funding of elementary and secondary education ranks 34th nationally.²⁵ As a result, the burden for funding local schools has increasingly shifted to localities, furthering a troubling funding

²³ See Government of the District of Columbia, *Tax Rates and Tax Burdens in the District of Columbia - A Nationwide Comparison* at 22 (December 2015), available at <https://cfo.dc.gov/sites/default/files/dc/sites/ocfo/publication/attachments/2014%2051City%20Study.pdf>.

²⁴ See, e.g., Kurt Erickson, *State Budget Woes Could Hamper Efforts to Boost Missouri Worker Pay*, St. Louis Post-Dispatch (January 11, 2017), available at http://www.stltoday.com/news/local/govt-and-politics/state-budget-woes-could-hamper-efforts-to-boost-missouri-worker/article_dfdcf0d2-3a02-50f8-b68b-5f27bc885085.html.

²⁵ *Public Comments from the Missouri Budget Project*, Submitted to the Governor's Committee for Simple, Fair and Low Taxes (May 10, 2017) at 1 [hereinafter Missouri Budget Project].

disparity amongst the State's school districts.²⁶ Additionally, Missouri has fallen behind the U.S. average for employment and personal income growth (see Figure 3 below), necessitating the need for bold tax reform.

Figure 3: U.S. and Missouri Economic Projections, FY2018²⁷

Economic Projections			
	Increase by Calendar Year		
<u>U.S.</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
Real GDP	1.8 %	2.6 %	2.5 %
Employment	1.7%	1.5%	1.5 %
Personal Income	4.3 %	4.2 %	4.7 %
Consumer Expenditures	2.7 %	3.1 %	3.1 %
Consumer Prices	1.3 %	2.7 %	2.5 %
<u>MISSOURI</u>			
Employment	1.1 %	1.4 %	1.2%
Personal Income	3.4 %	4.8 %	5.2 %

D. Overview of the Committee's Recommendations

The Committee's recommendations herein constitute a carefully balanced package that is projected to achieve a revenue neutral position from a static scoring perspective - the projection is attached hereto as Exhibit 1. The recommendations should be viewed as a comprehensive package, interlocked in order to ensure a revenue-neutral impact with significant long-term benefits for the State. The Committee has chosen not to expand its economic analysis to show enhanced economic activity and state revenue that result from the positive benefits it believes this package would instigate, leaving it to independent experts and observers to determine. By enacting the Committee's recommendations herein, Missouri's lawmakers can make Missouri a best-in-class state.

E. The Kansas Experiment

The Committee aimed to avoid the unintended consequences of Kansas's recently repealed 2012 and 2013 tax reforms, which resulted in massive budget deficits and funding reductions for schools, highways, and healthcare.²⁸ Upon review, the Committee observed several key issues with Kansas's tax policies:

²⁶ *Public Comments from the Missouri Budget Project*, Submitted to the Governor's Committee for Simple, Fair and Low Taxes (May 10, 2017) at 1 [hereinafter Missouri Budget Project].

²⁷ OFFICE OF ADMINISTRATION, DIVISION OF BUDGET & PLANNING, THE MISSOURI BUDGET FISCAL YEAR 2018 SUMMARY, https://oa.mo.gov/sites/default/files/FY_2018_Budget_Summary.pdf [hereinafter MISSOURI BUDGET FISCAL YEAR 2018 SUMMARY] (last visited June 12, 2017).

²⁸ Jeff Glendening, *Reckless spending caused Kansas budget crisis*, Kansas City Star (Feb. 16, 2017), available at <http://www.kansascity.com/opinion/readers-opinion/guest-commentary/article133225324.html>

- Kansas gave preferential tax treatment to certain business entities (discussed further below), resulting in major tax avoidance behavior and a corresponding 30% reduction of state revenue.²⁹ Rather than incentivizing actual business activity, Kansas merely favored pass-through entities over corporations.
- Kansas introduced large tax cuts based on unrealistic estimates of enhanced economic activity and resulting tax revenues, including a prediction of 100,000 private sector jobs created within the first four years following the legislation's enactment.
- Kansas did not design its large tax cuts to be revenue neutral. The tax cuts were not paired with other revenue enhancers or premeditated spending cuts. Instead, they relied on projections of future growth to balance their future budgets. When the enhanced economic activity failed to materialize, the deficit ballooned.
- The tax cuts happened all at once, rather than phasing in or being triggered by the occurrence of set economic targets, ultimately resulting in a budget deficit of approximately \$600 million.³⁰

To avoid Kansas's mistakes, the Committee has designed its recommendations using conservative estimated of revenue effects, aiming for fair and balanced tax implications for individuals and business entities, and, when practicable, recommending phase-in periods and triggers based on specific economic goals.

II. CORPORATE INCOME TAX

Much of the attention on business tax focuses on the corporate income tax. The corporate income tax can be perceived by legislatures and electorates as a fair method of tax, since profit-driven corporations must pay a portion of their net income back to the state in exchange for publically provided goods and services.³¹ States fill their coffers with corporate income tax instead of directly taxing their voting constituents.

The corporate income tax has gained widespread acceptance in state legislatures around the nation, with some variance in implementation. Forty-four states, including Missouri, levy a corporate income tax.³² The rate of corporate income taxation ranges from 3 percent in North Carolina to 12 percent in Iowa, with the average top state corporate income tax rate in the United States at 7.11 percent.³³ Missouri's rate stands at

²⁹ See Lindholm, *supra* note __; Nigel Duara, *Hard Times for Kansas Schools as Economic 'Experiment' Created Gaping Budget Hole*, Los Angeles Times (Nov. 21, 2016), available at <http://www.latimes.com/nation/la-na-kansas-hard-times-snap-20161121-story.html>.

³⁰ See Planet Money, *Episode 577: The Kansas Experiment*, National Public Radio (Jan. 11, 2017), available at <http://www.npr.org/sections/money/2017/01/11/509378842/episode-577-the-kansas-experiment>.

³¹ See Lindholm, *supra* note __.

³² Morgan Scarboro, *State Corporate Income Tax Rates and Brackets for 2017*, TAX FOUNDATION (Feb. 27, 2017), <https://taxfoundation.org/state-corporate-income-tax-rates-brackets-2017/>.

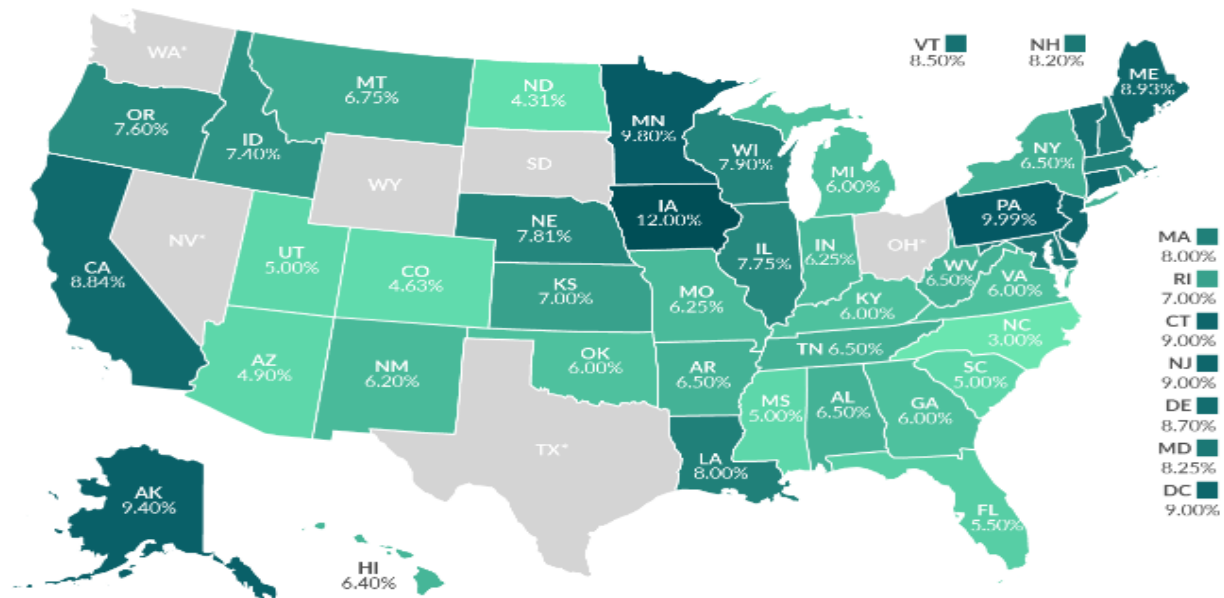
³³ Morgan Scarboro, *State Corporate Income Tax Rates and Brackets for 2017*, TAX FOUNDATION (Feb. 27, 2017), <https://taxfoundation.org/state-corporate-income-tax-rates-brackets-2017/>.

a flat 6.25 percent.³⁴ Kentucky and Oklahoma are Missouri's only two peer states with lower corporate income tax rates—5 percent and 6 percent, respectively. Of the states with a corporate income tax, 14 have a bracket system, ranging from 2 brackets (such as Kansas, Nebraska, New Mexico, and Oregon) to Alaska with 10 brackets.³⁵

Texas, Ohio, Nevada, and Washington levy a gross receipts tax in lieu of a corporate income tax.³⁶ South Dakota and Wyoming are the only states that do not impose a corporate income tax or a gross receipts tax.³⁷

Figure 6: Top State Marginal Corporate Income Tax Rates in 2017

Top State Marginal Corporate Income Tax Rates in 2017



Note: (*) Nevada, Ohio, Texas, and Washington do not have a corporate income tax but do have a gross receipts tax with rates not strictly comparable to corporate income tax rates. Arkansas has a "benefit recapture," by which corporations with more than \$100,000 of taxable income pay a flat tax of 6.5% on all income, not just on amounts above the benefit threshold. Connecticut's rate includes a 20% surtax, which effectively increases the rate from 7.5% to 9%. Surtax is required by businesses with at least \$100 million annual gross income. Illinois' rate includes two separate corporate income taxes, one at a 5.25% rate and one at a 2.5% rate. Indiana's tax rate will decrease to 6.0% on July 1, 2017.

Source: State tax statutes, forms, and instructions; Bloomberg BNA

A. Inherent Drawbacks

³⁴ Morgan Scarboro, *State Corporate Income Tax Rates and Brackets for 2017*, TAX FOUNDATION (Feb. 27, 2017), <https://taxfoundation.org/state-corporate-income-tax-rates-brackets-2017/>.

³⁵ Morgan Scarboro, *State Corporate Income Tax Rates and Brackets for 2017*, TAX FOUNDATION (Feb. 27, 2017), <https://taxfoundation.org/state-corporate-income-tax-rates-brackets-2017/>.

³⁶ Morgan Scarboro, *State Corporate Income Tax Rates and Brackets for 2017*, TAX FOUNDATION (Feb. 27, 2017), <https://taxfoundation.org/state-corporate-income-tax-rates-brackets-2017/>.

³⁷ Morgan Scarboro, *State Corporate Income Tax Rates and Brackets for 2017*, TAX FOUNDATION (Feb. 27, 2017), <https://taxfoundation.org/state-corporate-income-tax-rates-brackets-2017/>.

Despite the widespread acceptance, corporate income taxes inherently carry a multitude of drawbacks. Many academic studies have identified the corporate income tax as the number one factor that impairs a state's economic competitiveness.³⁸ Higher corporate taxes diminish a number of desirable economic activities such as business formation, firm relocation, investment, employment growth, and employee wages.³⁹ The corporate income tax regime allows corporate taxpayers to deduct interest payments but not dividend payments—as a result, corporations will leverage themselves through debt financing, which decreases taxable income while weakening the corporation's financial foundation.⁴⁰

Additionally, corporate income faces the specter of double taxation: first, the corporation itself pays taxes on its net income; subsequently, corporate shareholders pay taxes on the dividends distributed by the corporation.⁴¹

It is well understood that corporations do not bear the burden of the corporate income tax; the burden of the tax is borne by consumers, suppliers, employees and shareholders.⁴² Professor Greg Mankiw of Harvard University compares the corporation to a tax collector instead of a taxpayer.⁴³ Whether it is through higher prices or lower wages and benefits, Mankiw states, “the burden of the tax ultimately falls on people – the owners, customers, or workers of the corporation.”⁴⁴

³⁸ Hedlund, *supra* note 18 citing “Small Business Start-Ups in the United States: Estimates of the Effects of Characteristics of States” (Southern Economic Journal, 1989) by Bartik; “The Incidence and Efficiency Costs of Corporate Taxation When Corporate and Noncorporate Firms Produce the Same Good” (Journal of Political Economy, 1989) by Gravelle and Kotlikoff; “Tax Effects on Investment Location: Evidence for Foreign Direct Investment in the United States” (Office of Tax Policy Research, University of Michigan, 2001) by Agostini and Tulayasathien; “The Influence of Taxes on Employment and Population Growth: Evidence from the Washington, DC Metropolitan Area” (National Tax Journal, 2000) by McGuire and Papke; “Do States Choose Their Mix of Taxes to Minimize Employment Losses?” (National Tax Journal, 2003) by Harden and Hoyt; “Entrepreneurship and State Policy” (Unpublished Manuscript, 2017) by Curtis and Decker; “The Impact of Tax Cuts on Economic Growth: Evidence from the Canadian Provinces” (National Tax Journal, 2012) by Ferede and Dahlby; “The Impact and Inefficiency of the Corporate Income Tax: Evidence from State Organizational Form Data (Journal of Public Economics, 2004) by Goolsbee; and “State Taxation and the Reallocation of Business Activity: Evidence from Establishment-Level Data” (NBER Working Paper, 2015) by Giroud and Rauh.

³⁹ See Hedlund, *supra* note ____.

⁴⁰ See Hedlund, *supra* note ____.

⁴¹ See Hedlund, *supra* note ____.

⁴² Rob Norton, *Corporate Taxation*, LIBRARY OF ECONOMICS AND LIBERTY: THE CONCISE ENCYCLOPEDIA OF ECONOMICS (2008)
<http://www.econlib.org/library/Enc/CorporateTaxation.html>

⁴³ Andrew Chamberlain, *Who Really Pays the Corporate Income Tax?*, TAX FOUNDATION (May 4, 2006), <https://taxfoundation.org/who-really-pays-corporate-income-tax/> (citing Greg Mankiw, Corporate Tax Rates, GREG MANKIEW'S BLOG: RANDOM OBSERVATIONS FOR STUDENTS OF ECONOMICS, (May 3, 2006) <http://gregmankiw.blogspot.com/2006/05/corporate-tax-rates.html>)

⁴⁴ Andrew Chamberlain, *Who Really Pays the Corporate Income Tax?*, TAX FOUNDATION (May 4, 2006), <https://taxfoundation.org/who-really-pays-corporate-income-tax/> (citing Greg Mankiw, Corporate Tax Rates, GREG MANKIEW'S BLOG: RANDOM OBSERVATIONS FOR STUDENTS OF ECONOMICS (May 3, 2006), <http://gregmankiw.blogspot.com/2006/05/corporate-tax-rates.html>)

Further, most economists believe that the corporate income tax is a drag on economic activity because it is a material reduction of after tax investment returns, an administrative cost due to its complexity, and an inconsistent application of rules and regulations.⁴⁵ All of these factors congeal to reduce the attractiveness of a state's overall business environment.⁴⁶

B. Limited Materiality with Large Volatility

In addition to the inherent drawbacks, corporate income taxes raise a very small percentage of the tax revenue in Missouri and in most states in the union.⁴⁷

In 2015, Missouri's corporate income tax provided for 5.6% of the total state and local tax revenue.⁴⁸ This is the lowest percentage of state and local tax revenue of our peer states, except for Oklahoma with 5.4%.⁴⁹

Figure 3: Missouri composition of state and local business taxes by type, Fiscal Year 2015⁵⁰

⁴⁵ WILLIAM M. GENTRY, U.S. DEPT OF TREAS., A REVIEW OF THE EVIDENCE ON THE INCIDENCE OF THE CORPORATE INCOME TAX, (OTA Paper No. 101, 2007), available at [http:// www.treas.gov/offices/tax-policy/library/ota101.pdf](http://www.treas.gov/offices/tax-policy/library/ota101.pdf).

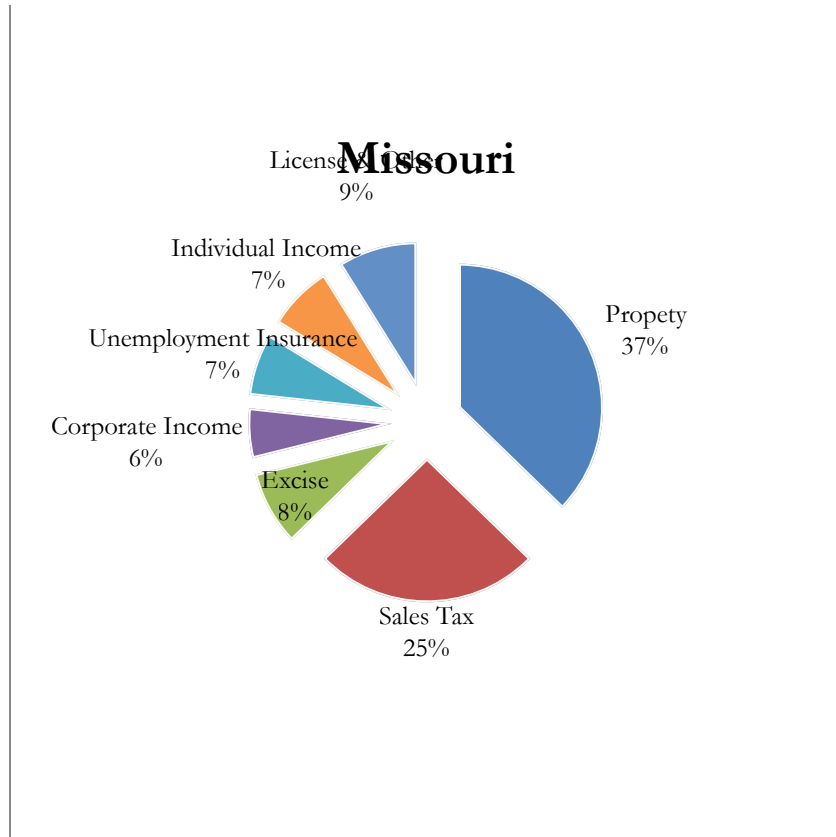
⁴⁶ See Hedlund, *supra* note ____.

⁴⁷ See Lindholm, *supra* note 18.

⁴⁸ See Hedlund, *supra* note 18.

⁴⁹ See Hedlund, *supra* note 18.

⁵⁰ See Lindholm, *supra* note ____.

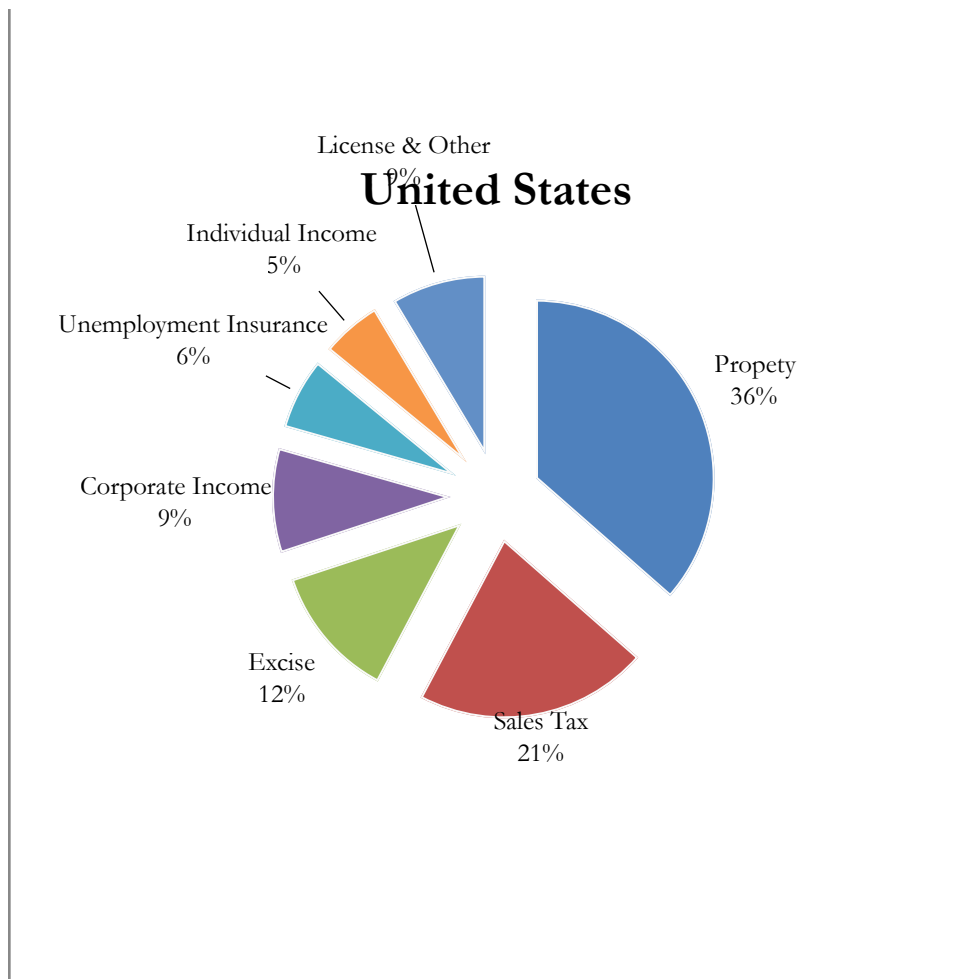


Nationwide corporate income taxes make up only 9.5 percent of the national total as shown below.⁵¹

Figure 4: Composition of state and local business taxes by type, Fiscal Year 2015⁵²

⁵¹ Morgan Scarboro, *To What Extent Does Your State Rely on Corporate Income Taxes?*, THE TAX FOUNDATION (April 19, 2017), <https://taxfoundation.org/corporate-income-taxes-percent-collections/>.

⁵² See Lindholm, *supra* note ____.



The corporate income tax produces minimal tax revenue from a volatile and unpredictable revenue source that is also susceptible to legislative tinkering. Corporate income tax is only collected when a corporation's profits are not offset by deductions, tax credits or other means of decreasing taxable income. Therefore, corporate income responds heavily to economic upswings and downturns.⁵³ According to Missouri Budget Project, revenue from Missouri's corporate income tax has dropped by 60% since 2015.⁵⁴ Missouri Budget Project believes this is largely in part to the legislative changes made to apportionment options for out of state companies.⁵⁵

C. Implementation Issues: Apportionment

Apportionment is the first of two major implementation issues that afflict Missouri corporate income tax. Apportioning Missouri corporate income tax to Missouri is simple—if you are a Missouri company that only has nexus in Missouri. The calculation is based on the federal taxable income reported on

⁵³ Lindholm

⁵⁴ Missouri Budget Project, *supra* note 46 at 6.

⁵⁵ Missouri Budget Project, *supra* note 46 at 6.

the corporation's federal tax return.⁵⁶ Then the return is adjusted based on any Missouri modifications and adjustments.⁵⁷ Finally, the tax is calculated at a flat rate of 6.25% of the Missouri Taxable Income.⁵⁸

However, for multi-state or multi-national corporate income tax filers, the calculation can be more complex. Under the Due Process Clause of the Fourteenth Amendment of the U.S. Constitution, a state may only tax income that is related to the business of the taxpayer conducted within the state.⁵⁹ This means that states are required to offer an apportionment method to a corporation with business from multiple states.⁶⁰ The goal is to avoid double taxation of the corporation's income.⁶¹

Missouri offers eight different apportionment methods.⁶² Comparable to other states, Missouri offers methods based on a specific industry, such as railroad or transportation.⁶³ However, Missouri also offers three methods for any corporation to choose.⁶⁴ This gives the taxpayer the opportunity to select the method that most benefits them including an optional single sales factor apportionment method.⁶⁵ The optional single sales factor apportionment method applies to sales other than the sale of tangible property and creates rules for market-based sourcing of such sales.⁶⁶ Unlike the commonly used Multistate Allocation and Three Factor Apportionment method, by which Missouri may impose a tax if a taxpayer has property and payroll in the state, the new, optional single sales method only requires corporations to report sales amounts.⁶⁷

⁵⁶ MO. REV. STAT. § 143.431 (2014).

⁵⁷ MO. REV. STAT. § 143.431 (2014).

⁵⁸ MO. REV. STAT. § 143.071 (2014).

⁵⁹ *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

⁶⁰ *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

⁶¹ See *Exxon Corporation v. Wis. Dep't of Revenue*, 447 U.S. 207 (1980). See also U.S. CONST. amend. XIV § 1; CONGRESSIONAL RESEARCH SERVICE, LIBRARY OF CONGRESS, CONSTITUTION OF THE UNITED STATES OF AMERICA: ANALYSIS, AND INTERPRETATION 1656-57 (Johnny H. Killian & George A. Costello, eds 1992), <https://www.gpo.gov/fdsys/pkg/GPO-CONAN-1992/pdf/GPO-CONAN-1992-10-15.pdf>

⁶² MO. REV. STAT. §§ 32.200 (Multistate Allocation and Three Factor Apportionment, Multistate Tax Compact); 143.451.2(2) (Business Transaction Single Factor Apportionment); 143.451.2(3) (Optional Single Sales Factor Apportionment); 143.451.3 (Transportation); 143.451.4 (Railroad); 143.451.5 (Interstate Bridge); 143.451.6 (Telephone and Telegraph); 143.461.2 (Other Approved Method).

⁶³ See MO. REV. STAT. §§ 143.451.3 (Transportation); 143.451.4 (Railroad).

⁶⁴ See MO. REV. STAT. §§ 32.200 (Multistate Allocation and Three Factor Apportionment, Multistate Tax Compact); 143.451.2(2) (Business Transaction Single Factor Apportionment); 143.461.2 (Other Approved Method).

⁶⁵ See MO. REV. STAT. § 143.451 (2013).

⁶⁶ See MO. REV. STAT. § 143.451 (2013).

⁶⁷ See MO. REV. STAT. § 143.451 (2013).

The Missouri Budget Project submitted written testimony to the Committee, in which it advocated replacing all current apportionment options with a simple, single sales factor formula that all companies must utilize.⁶⁸ Thirty-seven states currently use sales as the basis for apportioning multi-state company's income.⁶⁹

D. Implementation Issue: Corporate Income Tax Giveaway

The second major implementation issue with the Missouri corporate income tax is the deduction for Federal Income Tax. Missouri corporate taxpayers may deduct fifty-percent of their Federal Corporate Income Tax from their state corporate income tax.⁷⁰ In Tax Year 2014, Missouri lost approximately than \$92.9 million in revenue due to the Federal Income Tax Deduction.⁷¹

E. Pass-through Income

The corporate income tax's interplay with pass-through income illustrates a larger point: the corporate income tax is not levied on all types of business income. In fact, the corporate income tax does very little to tax income earned by non-corporate legal entities such as partnership and LLCs, which are commonly known as pass-through entities. The majority of business in the United States is actually not conducted by traditional corporations and is instead operated as pass through entities and sole proprietorships.⁷² In 2014, only 8.1 percent of companies in the United States were C Corporations and almost 70 percent of companies were sole proprietorships.⁷³

Figure 7: Share of Private Business Establishments by Form, 2014

⁶⁸ Missouri Budget Project, *supra* note 46 at 6.

⁶⁹ Missouri Budget Project, *supra* note 46 at 6.

⁷⁰ RSMo. 143.171.2

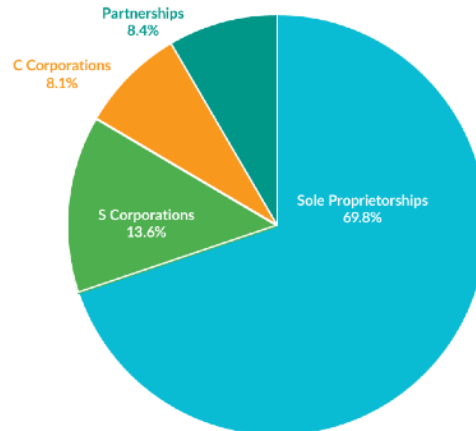
⁷¹ Email from Michael Harris (Taxation Legislative Coordinator) to Kayla Jeffers on 5/31/2017.

⁷² Scott Greenberg, *Pass-Through Businesses: Data and Policy* TAX FOUNDATION, Jan. 17 2017, <https://taxfoundation.org/pass-through-businesses-data-and-policy/>.

⁷³ Scott Greenberg, *Pass-Through Businesses: Data and Policy* TAX FOUNDATION, Jan. 17 2017, <https://taxfoundation.org/pass-through-businesses-data-and-policy/>.

The Majority of Companies in the U.S. are Pass-Through Businesses

Share of Private Business Establishments by Form, 2014



Source: Census County Business Patterns (2014) and Non-Employer Statistics (2014)

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Best practice suggests that the business activities of traditional corporations, pass through entities and sole proprietorships should all be taxed in the same manner. Similar tax treatment would seek to eliminate any tax motivation in the choice of a particular legal entity type over all others and most tax disparity in the after tax returns. Similar tax treatment would call for a system that taxes the income once, and at the same tax rate for all businesses.⁷⁴

Kansas has pursued the opposite course. In 2012, Kansas enacted a tax cut package that eliminating income tax on pass through entities such as LLCs, partnerships, sole proprietors, etc.⁷⁵ As a result, some taxpayers have been able to achieve a 0% tax based simply on their legal entity choice. Most states that are trying to implement some kind of tax reform are focusing on broadening the base and lowering the rates.⁷⁶ By eliminating pass through income, Kansas narrowed the base.⁷⁷ When the narrow base was combined with additional rate cuts, Kansas endured years of budget shortfalls and cuts to education that led the state to repeal their reforms over Governor Brownback's veto on June 7, 2017.⁷⁸ We have learned from that experience and have carefully thought through this issue as highlighted above.

⁷⁴ See *Pass-Through Entities: States Take Varied Approaches Applying Corporate Tax Law Concepts, Reporting Requirements*, BLOOMBERG BNA: DAILY TAX REPORT – STATE (April 28, 2017) (2017 WSTR Issue No. 48). See also *TAXING BUSINESSES THROUGH THE INDIVIDUAL INCOME TAX*, CONGRESSIONAL BUDGET OFFICE 20-25 (Dec. 2012) (discussing policy implications of federal tax reform that would specify the taxation of pass-through entities), https://www.cbo.gov/sites/default/files/112th-congress-2011-2012/reports/TaxingBusinesses_OneColumn.pdf.

⁷⁵ Scott Drenkard & Joseph Henchman, *Testimony: Reexamining Kansas' Pass-through Carve-out*, TAX FOUNDATION, Jan. 19 2017, <https://taxfoundation.org/testimony-reexamining-kansas-pass-through-carve-out/>.

⁷⁶ Scott Drenkard & Joseph Henchman, *Testimony: Reexamining Kansas' Pass-through Carve-out*, TAX FOUNDATION, Jan. 19 2017, <https://taxfoundation.org/testimony-reexamining-kansas-pass-through-carve-out/>.

⁷⁷ Scott Drenkard & Joseph Henchman, *Testimony: Reexamining Kansas' Pass-through Carve-out*, TAX FOUNDATION, Jan. 19 2017, <https://taxfoundation.org/testimony-reexamining-kansas-pass-through-carve-out/>.

⁷⁸ Bryan Lowry, "Kansas tax 'experiment' offers lessons to the nation, analysts say," *The Kansas City Star* (June 7, 2017), <http://www.kansascity.com/news/politics-government/article154962419.html>

In response to Kansas' action on pass-through entities, the Missouri General Assembly passed Senate Bill 509. Senate Bill 509 enabled taxpayers to subtract a portion of their business income from their federal adjusted gross income. It also allowed owners of small corporations or partnerships to deduct their share of ownership of the business.⁷⁹ The legislation established a gradual increase to the business income deduction of five percent per year, with a maximum after five years of twenty-five percent.⁸⁰ When fully implemented, Senate Bill 509 had an estimated reduction in revenue of \$620.9 million, in the fifth year.⁸¹

Professor Hedlund also addressed the Kansas tax cut, and advised the Committee to consider lessons learned from other states when making their recommendation:

“Kansas mistakenly reduced the tax rate on pass-through income to zero, far below that of regular income. This change has little justification economically and has greatly encouraged tax avoidance behavior through income reclassification. Indiana has moved up the ranks of business-friendly states partly by setting in motion a gradual reduction in the corporate tax rate from 8.5% down to 4.9% by 2022.”⁸²

The inherent difficulties, volatility, the complexity in implementation and the narrow tax base all make the corporate tax unpalatable. Some states have pursued a replacement in the form of a gross receipts tax.

F. Gross Receipts Tax

Gross receipts taxes first became popular in the late 1920s and early 1930s, due to decreased state revenues from the Great Depression. In the 1960s, a number of state courts started to deem the tax unconstitutional and forced their repeal. However, many states have been considering the reintroduction of a gross receipts tax. Gross receipts taxes have been found to produce large and stable amounts of revenue, and have a wider base from which to generate revenue quickly. Since the gross receipts tax levies a tax on gross receipts rather than net income, the gross receipts tax is more predictable than a corporate income tax.⁸³

The gross receipts tax also provides states with the ability to collect tax on remote sellers who do not have physical presence in the state. The Committee looked at this closely due to the estimated tax gap currently existing in this area. Identifying a way to collect or replace this lost revenue would greatly assist the State's fiscal position while only collecting the tax that it is currently owed.⁸⁴

⁷⁹ Scott Greenberg, *Pass-Through Businesses: Data and Policy* TAX FOUNDATION, Jan. 17 2017, <https://taxfoundation.org/pass-through-businesses-data-and-policy/>.

⁸⁰ Scott Greenberg, *Pass-Through Businesses: Data and Policy* TAX FOUNDATION, Jan. 17 2017, <https://taxfoundation.org/pass-through-businesses-data-and-policy/>.

⁸¹ Scott Greenberg, *Pass-Through Businesses: Data and Policy* TAX FOUNDATION, Jan. 17 2017, <https://taxfoundation.org/pass-through-businesses-data-and-policy/>.

⁸² Hedlund, *supra* note 18 at 6.

⁸³ Eric J. Coffill & Jessica N. Allen, *Some Observations on Gross Receipts Taxes*, 27 JUL. MULTISTATE TAX'N 14 (2017).

⁸⁴ Francina A. Dlouhy et al., *Implementation & Administration Issues in Administering Gross Receipts Taxes: Perspectives from State Administrators & Taxpayers*, 2009 WL 2589532 (2009).

Critics of the gross receipts tax point to a negative impact on businesses with low net income or even loss positions, which could have high effective tax rates under the gross receipts test. Also, some say it can lead to higher consumer prices, lower wages, and fewer job opportunities.⁸⁵ After investigating the gross receipts tax experiences of Indiana, New Jersey, Kentucky, and Michigan, Nicole Kaeding of the Tax Foundation wrote, “these types of taxes violate principles of sound tax policy. They are not neutral, competitive, fair, transparent, nor equitable.”⁸⁶

Gross receipts tax can be referred to as an “alternative base tax.”⁸⁷ In the testimony from COST, Mr. Lindholm recommends avoiding “alternative base” business taxes.⁸⁸ He states, “Gross receipts taxes are widely acknowledged to violate numerous tax policy principles,” such as tax pyramiding.⁸⁹ Tax pyramiding results when goods and services are taxed multiple times during production and distribution.⁹⁰

The Committee recognizes pyramiding as an issue with a gross receipts tax. However, the low rate of tax does not have as much of an impact as it would at a standard tax rate. Below is an example from COST of tax pyramiding:⁹¹

Figure 16: Example of pyramiding of taxes on business inputs

Components of total production and distribution costs	Appliance manuf.		Retailer		Final customer		Sales tax all stages	Effective tax rate
	Purchases	Sales tax	Purchases	Sales tax	Purchases	Sales tax		
Appliance Manufacturer								
Circuit boards	\$200	\$0	\$200	\$0	\$200	\$12.00	\$12.00	6.0%
Labor and profits	1,000	0	1,000	0	1,000	60.00	60.00	6.0%
Office equipment	40	2.40	40	2.40	40	2.40	7.20	18.0%
Outsourced services	100	6.00	100	6.00	100	6.00	18.00	18.0%
Retailer								
Labor and profits			\$100	\$0	\$100	\$6.00	\$6.00	6.0%
Office equipment			20	1.20	20	\$1.20	\$2.40	12.0%
Outsourced services		10	0.60		10	\$0.60	\$1.20	12.0%
Total appliance cost to consumer					\$1,470	\$88.20	\$106.80	7.3%
Sales tax summary								
Ideal retail sales tax on final sales		\$0.00		\$0.00		\$88.20	\$88.20	6.0%
Actual taxes on intermediate & final sales								
Without taxes on service inputs		\$2.40		\$3.60		\$88.20	\$94.20	6.4%
With taxes on service inputs		\$8.40		\$10.20		\$88.20	\$106.80	7.3%

⁸⁵ Eric J. Coffill & Jessica N. Allen, *Some Observations on Gross Receipts Taxes*, 27 JUL J. MULTISTATE TAX’N 14 (2017).

⁸⁶ Nicole Kaeding, *Gross Receipts Taxes: Lessons from Previous State Experiences*, TAX FOUNDATION Aug. 10, 2016, <https://taxfoundation.org/gross-receipts-taxes-state-experiences/>.

⁸⁷ Lindholm, *supra* note 82.

⁸⁸ Lindholm, *supra* note 82.

⁸⁹ Lindholm, *supra* note 82.

⁹⁰ Robert CLINE, ANDREW PHILLIPS & THOMAS NEUBIG, WHAT’S WRONG WITH TAXING BUSINESS SERVICES? ADVERSE EFFECTS FROM EXISTING AND PROPOSED SALES TAXATION OF BUSINESS INVESTMENT AND SERVICES (April 4, 2013) <http://www.cost.org/WorkArea/DownloadAsset.aspx?id=83841>.

⁹¹ Robert CLINE, ANDREW PHILLIPS & THOMAS NEUBIG, WHAT’S WRONG WITH TAXING BUSINESS SERVICES? ADVERSE EFFECTS FROM EXISTING AND PROPOSED SALES TAXATION OF BUSINESS INVESTMENT AND SERVICES (April 4, 2013) <http://www.cost.org/WorkArea/DownloadAsset.aspx?id=83841>.

However, some states have found the right way to make it work. Ohio implemented its Commercial Activity Tax (CAT) in 2005 when it passed House Bill 66.⁹² The CAT is used to impose a tax on the privilege of doing business in Ohio.⁹³ The business privilege tax is measured by gross receipts.⁹⁴ House Bill 66 also steadily phased out tangible personal property tax and corporate franchise tax for most businesses in Ohio.⁹⁵

Ohio has shown that if the rate is kept low and the base is broad, gross receipts tax can be an effective tool.⁹⁶ Ohio imposes an annual minimum tax for filers with annual taxable gross receipts of more than \$150,000.⁹⁷ If a business has annual gross receipts above \$1 million, it is required to pay the annual minimum tax plus the tax rate of .26% for the amount exceeding the first \$1 million.⁹⁸

The CAT has also allowed Ohio to address the remote seller nexus issue.⁹⁹ Instead of trying to subject taxpayers to a sales tax (which would require physical presence in the state and thus excludes most remote sellers), the CAT instead subjects taxpayer to income tax due to a bright-line presence test.¹⁰⁰ A taxpayer meets the bright-line presence test if it:

⁹² OHIO DEPARTMENT OF TAXATION, FISCAL YEAR 2015 ANNUAL REPORT:COMMERCIAL ACTIVITY TAX SECTION, http://www.tax.ohio.gov/Portals/0/communications/publications/annual_reports/2015_annual_report/2015_AR_Section_2_Commercial_Activity_Tax.pdf [hereinafter OHIO DEPARTMENT OF TAXATION] (citing Ohio's 2005 House Bill 66).

⁹³ OHIO DEPARTMENT OF TAXATION, FISCAL YEAR 2015 ANNUAL REPORT:COMMERCIAL ACTIVITY TAX SECTION, http://www.tax.ohio.gov/Portals/0/communications/publications/annual_reports/2015_annual_report/2015_AR_Section_2_Commercial_Activity_Tax.pdf [hereinafter OHIO DEPARTMENT OF TAXATION].

⁹⁴ OHIO DEPARTMENT OF TAXATION, FISCAL YEAR 2015 ANNUAL REPORT:COMMERCIAL ACTIVITY TAX SECTION, http://www.tax.ohio.gov/Portals/0/communications/publications/annual_reports/2015_annual_report/2015_AR_Section_2_Commercial_Activity_Tax.pdf [hereinafter OHIO DEPARTMENT OF TAXATION].

⁹⁵ OHIO DEPARTMENT OF TAXATION, FISCAL YEAR 2015 ANNUAL REPORT:COMMERCIAL ACTIVITY TAX SECTION, http://www.tax.ohio.gov/Portals/0/communications/publications/annual_reports/2015_annual_report/2015_AR_Section_2_Commercial_Activity_Tax.pdf [hereinafter OHIO DEPARTMENT OF TAXATION].

⁹⁶ OHIO DEPARTMENT OF TAXATION, FISCAL YEAR 2015 ANNUAL REPORT:COMMERCIAL ACTIVITY TAX SECTION, http://www.tax.ohio.gov/Portals/0/communications/publications/annual_reports/2015_annual_report/2015_AR_Section_2_Commercial_Activity_Tax.pdf [hereinafter OHIO DEPARTMENT OF TAXATION].

⁹⁷ OHIO DEPARTMENT OF TAXATION, FISCAL YEAR 2015 ANNUAL REPORT:COMMERCIAL ACTIVITY TAX SECTION, http://www.tax.ohio.gov/Portals/0/communications/publications/annual_reports/2015_annual_report/2015_AR_Section_2_Commercial_Activity_Tax.pdf [hereinafter OHIO DEPARTMENT OF TAXATION].

⁹⁸ OHIO DEPARTMENT OF TAXATION, FISCAL YEAR 2015 ANNUAL REPORT:COMMERCIAL ACTIVITY TAX SECTION, http://www.tax.ohio.gov/Portals/0/communications/publications/annual_reports/2015_annual_report/2015_AR_Section_2_Commercial_Activity_Tax.pdf [hereinafter OHIO DEPARTMENT OF TAXATION].

⁹⁹ OHIO DEPARTMENT OF TAXATION, CAT 2005-02 – COMMERCIAL ACTIVITY TAX: NEXUS STANDARDS – SEPTEMBER, 2005 (May, 2011), http://www.tax.ohio.gov/portals/0/commercial_activities/information_releases/cat200502.pdf.

¹⁰⁰ OHIO DEPARTMENT OF TAXATION, CAT 2005-02 – COMMERCIAL ACTIVITY TAX: NEXUS STANDARDS – SEPTEMBER, 2005 (May, 2011), http://www.tax.ohio.gov/portals/0/commercial_activities/information_releases/cat200502.pdf.

- “Has at any time during the calendar year property in this state with an aggregate value of at least \$50,000
- Has during the calendar year payroll in this state of at least \$50,000
- Has during the calendar year taxable gross receipts in this state of at least \$500,000
- Has at any time during the calendar year within this state at least 25 percent of the persons total property, total payroll, or total gross receipts
- Is domiciled in this state as an individual or for corporate, commercial, or other business purposes.”¹⁰¹

With these standards set in place, they have been able to tax any remote sellers who meet this criterion.

Some argue that a corporate income tax with a single factor apportionment based on sales is a short step from a gross receipts tax and since Missouri has the election for a single factor apportionment it is not that big a movement to enact a gross receipts tax.¹⁰²

In his testimony before the committee, Bob Cline noted that over the past decade, Ohio’s CAT has displayed a number of positive qualities.¹⁰³ First, the gross receipts tax has a very stable base. Actual gross receipts revenues in 2012 were only 5% below their 2005 estimates, despite the intervening Great Recession.¹⁰⁴ The Ohio legislature has not changed the tax rate since the CAT was first implemented, thus evidencing the tax’s political stability and assuaging fears of a slippery-slope of tax increases.¹⁰⁵ Large, profitable businesses have maintained their support of the CAT, even as low-margin, high volume retailers have been opposed.¹⁰⁶ Finally, the CAT provides few tax planning opportunities to erode the tax base.¹⁰⁷

G. Other State Approaches

¹⁰¹ OHIO DEPARTMENT OF TAXATION, CAT 2005-02 – COMMERCIAL ACTIVITY TAX: NEXUS STANDARDS – SEPTEMBER, 2005 (May, 2011), http://www.tax.ohio.gov/portals/0/commercial_activities/information_releases/cat200502.pdf.

¹⁰² Cline

¹⁰³ Bob Cline, *State Business Tax Reform, Presentation to Missouri Governor’s Committee for Simple, Fair and Low Taxes* (May 15, 2017).

¹⁰⁴ Bob Cline, *State Business Tax Reform, Presentation to Missouri Governor’s Committee for Simple, Fair and Low Taxes* (May 15, 2017).

¹⁰⁵ Bob Cline, *State Business Tax Reform, Presentation to Missouri Governor’s Committee for Simple, Fair and Low Taxes* (May 15, 2017).

¹⁰⁶ Bob Cline, *State Business Tax Reform, Presentation to Missouri Governor’s Committee for Simple, Fair and Low Taxes* (May 15, 2017).

¹⁰⁷ Bob Cline, *State Business Tax Reform, Presentation to Missouri Governor’s Committee for Simple, Fair and Low Taxes* (May 15, 2017).

Other states have taken different approaches. Minnesota imposes a relatively standard franchise tax.¹⁰⁸ Minnesota imposes a minimum fee on all corporations and partnerships for doing business in the state.¹⁰⁹ The minimum fee is based on total amount of sales, payroll, or property sourced in the state.¹¹⁰

Texas administers a Margin Tax, which is a hybrid between a gross receipts tax and a corporate franchise tax.¹¹¹ Imposed solely on entities, it is difficult to calculate as it is a tax upon a margin, which is determined with total revenue and certain deductions. Further, the tax is heavily tailored by industry with myriad deductions and exclusions allowed by type of taxable entity.

H. Recommendations

Recommendation: Eliminate Missouri's current corporate income tax and replace it with a broad based gross receipts tax. Missouri's current corporate income tax structure is complex, high and slanted towards special interests who can afford lobbyists, accountants and tax lawyers to wade through the morass of statutes and regulations. A gross receipts replacement would even the playing field in a number of ways. It would reduce reducing tax planning opportunities. No longer would corporations be able to take on excessive amounts of debt in an attempt to decrease their state effective corporate income tax rate by taking interest payment deductions. Unlike a corporate income tax, a gross receipts tax has no deductions. Also, a gross receipts tax would end the apportionment method debate by requiring all entities to adopt the single factor sale tax method.

Additionally, a gross receipts tax would simplify state tax compliance. Taxpayers would be able to complete their entire state income tax return on a postcard sized document. The post card sized document would contain one entry for total gross receipts in Missouri, and then ask the taxpayer to multiply that amount by 0.225% to end up with total income tax owed to the state.

Moreover, all entities would be treated equally. No matter whether a taxpayer chooses to organize their business as a corporation, a partnership or a sole proprietorship, each of these entities would be subject to the same, low tax rate.

The gross receipts tax could be phased in over three years. Within a year of the enactment of the tax reform package, the Department of Revenue would implement a system to handle the alterations to the corporate income tax. Then, beginning on January 1 of the year after implementation of the new system, the corporate tax rate would be reduced to 3.25% and gross receipts would be taxed at 0.1125%. The year after implementation, the corporate tax would be eliminated entirely and the gross receipts tax would rise to its full 0.225%.

¹⁰⁸ Joel Michael, *Corporate Franchise Tax*, THE RESEARCH DEP'T OF THE MINN. HOUSE OF REPRESENTATIVES (June 2015), <http://www.house.leg.state.mn.us/hrd/pubs/ss/sscorpft.pdf>.

¹⁰⁹ *Where Can I Get the From M4 Series?*, MINN. DEP'T OF REVENUE, <http://www.revenue.state.mn.us/Pages/FAQ.aspx?WebId=bdadcc45%2Dd292%2D4cbe%2D9a25%2Dd63acdab3f54&Owner=Corporation%20Franchise%20Tax&Topic=What%27s%20New#FAQ23> (last accessed June 16, 2017).

¹¹⁰ Joel Michael, *Corporate Franchise Tax*, THE RESEARCH DEP'T OF THE MINN. HOUSE OF REPRESENTATIVES (June 2015), <http://www.house.leg.state.mn.us/hrd/pubs/ss/sscorpft.pdf>.

¹¹¹ *Understanding the Texas Franchise – or “Margin” – Tax*, TEXAS TAXPAYERS AND RESEARCH ASSOCIATION (Oct. 2011), <http://www.ttara.org/files/document/file-4ea5bda9239ef.pdf>.

Recommendation: As the implementation and phase-in takes place, Missouri should also repeal the state corporate income tax deduction for federal corporate income taxes paid.

III. INDIVIDUAL INCOME TAX

Individual income tax is the largest source of tax revenue for Missouri.¹¹² The state gathers 49.2% of its revenue from individual income taxes.¹¹³ This is significantly higher than the national average of 37.2%, and the 35.4% rate average among our peer states, excluding Tennessee, which exclusively taxes dividends and interest income.¹¹⁴

Two factors make the individual income tax simple, cost effective and attractive to many taxpayers. First, the majority of the tax is deducted from taxpayers' paychecks and paid to the state from the employer.¹¹⁵ Second, Missouri starts its taxable income calculation from a figure that each taxpayer must calculate regardless of state tax: the taxpayer's federal taxable income.¹¹⁶

However, despite its ease of implementation, the tax is an inefficient one and less desirable than other tax regimes for a number of reasons, as laid out by Professor Hedlund:

1. When states tax income, they implicitly discourage productive activity that would otherwise benefit society and the economy, including work, risk-taking, saving, investment, and the accumulation of monetary and human capital.
2. Rising marginal tax rates depress growth¹¹⁷
3. State income tax rates deeply impact labor market high performers¹¹⁸

The Committee also considered lessons from other states. Missouri remains in the middle of the pack for individual income tax competitiveness.¹¹⁹ North Carolina and Indiana have vaulted to the cutting

¹¹² FEDERATION OF TAX ADMINISTRATORS, 2016 STATE 2016 STATE TAX COLLECTION BY SOURCE (2016) (relying on data from the U.S. Bureau of the Census) <https://www.taxadmin.org/2016-state-tax-collection-by-source>.

¹¹³ FEDERATION OF TAX ADMINISTRATORS, 2016 STATE 2016 STATE TAX COLLECTION BY SOURCE (2016) (relying on data from the U.S. Bureau of the Census) <https://www.taxadmin.org/2016-state-tax-collection-by-source>.

¹¹⁴ FEDERATION OF TAX ADMINISTRATORS, 2016 STATE 2016 STATE TAX COLLECTION BY SOURCE (2016) (relying on data from the U.S. Bureau of the Census) <https://www.taxadmin.org/2016-state-tax-collection-by-source>.

¹¹⁵ See MO. REV. STAT. § 143.191 (2016).

¹¹⁶ See MO. REV. STAT. § 143.121 (2016).

¹¹⁷ Hedlund, citing "Nonlinear Effects of Taxation on Growth" (Journal of Political Economy, 2017) by Jaimovich and Rebelo.

¹¹⁸ Hedlund, citing "The Effect of State Taxes on the Geographical Location of Top Earners: Evidence from Star Scientists" by Enrico Moretti and Daniel Wilson.

¹¹⁹ Hedlund, *supra* note 18..

edge of income tax reformers due to recent legislation.¹²⁰ At the other end of the spectrum, states like California suffer from cyclical revenue volatility in part due to income tax surcharges on high incomes.”¹²¹

A. Rates and Brackets

A comparison to other states will provide context to the Committee’s conclusions. Forty-three states levy individual income taxes.¹²² The average top state individual income tax rate in the United States is 6.41%, which is above Missouri’s top rate of 6%.¹²³

Missouri’s tax brackets were established in 1931.¹²⁴ Missouri and California are the only two states in the country with 10 individual income tax brackets. Our peer states have enacted tax brackets that range from 2 to 8 brackets, with a median of six.¹²⁵ Illinois and Tennessee apply flat rates, and Tennessee exclusively taxes dividends and interest income.¹²⁶ Alabama and Georgia are the only two states that begin taxing individuals at a lower level than Missouri. Only three states have their highest individual tax bracket at a lower level of income than Missouri.¹²⁷

Missouri’s top rate is 6%, and it applies to individuals with a Missouri taxable income over \$9,000.¹²⁸ The current rate structure was implemented in 1971, when the average wage in the United States was slightly

¹²⁰ Hedlund, *supra* note 18.

¹²¹ Hedlund, *supra* note 18.

¹²² Nicole Kaeding, *State Individual Income Tax Rates and Brackets for 2016*, TAX FOUNDATION (Feb. 8, 2016), <https://taxfoundation.org/state-individual-income-tax-rates-and-brackets-2016/> [hereinafter *State Individual Income Tax Rates and Brackets for 2016*].

¹²³ Nicole Kaeding, *State Individual Income Tax Rates and Brackets for 2016*, TAX FOUNDATION (Feb. 8, 2016), <https://taxfoundation.org/state-individual-income-tax-rates-and-brackets-2016/> [hereinafter *State Individual Income Tax Rates and Brackets for 2016*].

¹²⁴ Press Release, Institute on Taxation and Economic Policy, *State Taxes Hit Poor & Middle Class Missourians Far Harder than Wealthy, New Report Shows* (Nov. 18, 2009), <http://www.mobudget.org/files/Who%20Pays%20Release%202009.pdf>].

¹²⁵ Nicole Kaeding, *State Individual Income Tax Rates and Brackets for 2016*, TAX FOUNDATION (Feb. 8, 2016), <https://taxfoundation.org/state-individual-income-tax-rates-and-brackets-2016/> [hereinafter *State Individual Income Tax Rates and Brackets for 2016*].

¹²⁶ Nicole Kaeding, *State Individual Income Tax Rates and Brackets for 2016*, TAX FOUNDATION (Feb. 8, 2016), <https://taxfoundation.org/state-individual-income-tax-rates-and-brackets-2016/> [hereinafter *State Individual Income Tax Rates and Brackets for 2016*].

¹²⁷ Alabama, Georgia and Oklahoma. Nicole Kaeding, *State Individual Income Tax Rates and Brackets for 2016*, TAX FOUNDATION (Feb. 8, 2016), <https://taxfoundation.org/state-individual-income-tax-rates-and-brackets-2016/> [hereinafter *State Individual Income Tax Rates and Brackets for 2016*].

¹²⁸ Nicole Kaeding, *State Individual Income Tax Rates and Brackets for 2016*, TAX FOUNDATION (Feb. 8, 2016), <https://taxfoundation.org/state-individual-income-tax-rates-and-brackets-2016/> [hereinafter *State Individual Income Tax Rates and Brackets for 2016*].

over \$6,400¹²⁹ The current structure is now outdated, as shown by the following study by The Institute on Taxation and Economic Policy that adjusted Missouri's current brackets for inflation:¹³⁰

Figure 17: Missouri income tax brackets if adjusted for inflation, based on 2016 data

2016 Actual Brackets	2016 Brackets if Adjusted for Inflation
\$1,000	\$15,846
\$2,000	\$31,691
\$3,000	\$47,537
\$4,000	\$63,382
\$5,000	\$79,228
\$6,000	\$95,074
\$7,000	\$110,919
\$8,000	\$126,765
\$9,000	\$142,610

As a result of Missouri's outdated structure, some consider the State to have a flat income tax, in which middle income families are taxed at the same rate as high income earners. In its written submission to the Committee, the Missouri Budget Project noted that Missouri's tax structure creates a heavier burden on lower income taxpayers.¹³¹ According to data from the Institute on Taxation and Economic Policy, low-wage workers in Missouri who earn less than \$53,000 per year pay 9 percent or more of their income in state and local taxes, while Missourians earning more than \$407,000 per year pay just 5.5 percent of their income in state and local taxes."¹³²

In 2014, the Missouri General Assembly passed Senate Bill 509 and put in place a tax trigger to ultimately lower the top income tax rate to 5.5%.¹³³ The bill states, "Each reduction in the top rate of tax shall be by one-tenth of a percent and no more than one reduction shall occur in a calendar year."¹³⁴ Senate Bill 509 contained triggers that would prevent a tax rate decrease from occurring unless "the amount of net general revenue collected in the previous fiscal year exceed the highest amount of net general revenue collected in any of the three fiscal years prior to such fiscal year by at least \$150 million."¹³⁵ This bill is a good

¹²⁹ SOCIAL SECURITY ADMINISTRATION, NATIONAL WAGE INDEX (2015), <https://www.ssa.gov/oact/cola/AWI.html>.

¹³⁰ SOCIAL SECURITY ADMINISTRATION, NATIONAL WAGE INDEX (2015), <https://www.ssa.gov/oact/cola/AWI.html>.

¹³¹ Missouri Budget Project, *supra* note ____

¹³² Missouri Budget Project, *supra* note ____

¹³³ See SB 509 & 496, *supra* note 125.

¹³⁴ See SB 509 & 496, *supra* note 125.

¹³⁵ See SB 509 & 496, *supra* note 125.

step in the right direction. However, Senate Bill 509 only applied to the top rate of tax.¹³⁶ If Missouri wants simple, fair, and low individual income taxes, a restructuring of all individual income tax brackets is necessary.

Since the individual income tax raises such a significant proportion of overall state revenue, any change in the regime will have very large revenue implications. The Committee conducted a review of current filers to put this into context. If Missouri were to keep its same rate structure and impose a 1% decrease to top rate in the table, the state would see a reduction in revenue of \$858.2 million.¹³⁷

B. Base

The base of the corporate income—which determines what is and what is not taxable—impacts the total revenues collected, just as the rates do. Of the eight states that border Missouri, six have a standard deduction.¹³⁸ The deductions range from \$2,000 to \$6,350,¹³⁹ three states (including Missouri) have a standard deduction equal to the federal deduction for the same filing status. All, except Kentucky, with a standard deduction increase the deduction by at least double for the married filing status.¹⁴⁰

Missouri and its contiguous states have a personal exemption, which doubles in size when the taxpayers are married filing jointly.¹⁴¹ The exemption amounts range from \$10 to \$2,250.¹⁴² Missouri offers a personal exemption of \$2,100 for individuals and \$4,200 for couples. Seven contiguous states and Missouri offer an exemption rate for a filing status of dependent.¹⁴³ All of these states, except Missouri offer the same amount as a personal exemption.¹⁴⁴

A common complaint heard from citizens regarding the complexity of the individual income tax system is the division of income between spouses. Currently, when filing a joint return in the state of

¹³⁶ See SB 509 & 496, *supra* note 125.

¹³⁷ Nicole Kaeding & Kyle Pomerleau, *Federal Tax Reform: The Impact on States*, TAX FOUNDATION (March 8, 2017), <https://taxfoundation.org/federal-tax-reform-the-impact-on-states/> [hereinafter *Federal Tax Reform: The Impact on States*].

¹³⁸ Nicole Kaeding & Kyle Pomerleau, *Federal Tax Reform: The Impact on States*, TAX FOUNDATION (March 8, 2017), <https://taxfoundation.org/federal-tax-reform-the-impact-on-states/> [hereinafter *Federal Tax Reform: The Impact on States*].

¹³⁹ Nicole Kaeding & Kyle Pomerleau, *Federal Tax Reform: The Impact on States*, TAX FOUNDATION (March 8, 2017), <https://taxfoundation.org/federal-tax-reform-the-impact-on-states/> [hereinafter *Federal Tax Reform: The Impact on States*].

¹⁴⁰ Nicole Kaeding & Kyle Pomerleau, *Federal Tax Reform: The Impact on States*, TAX FOUNDATION (March 8, 2017), <https://taxfoundation.org/federal-tax-reform-the-impact-on-states/> [hereinafter *Federal Tax Reform: The Impact on States*].

¹⁴¹ Nicole Kaeding & Kyle Pomerleau, *Federal Tax Reform: The Impact on States*, TAX FOUNDATION (March 8, 2017), <https://taxfoundation.org/federal-tax-reform-the-impact-on-states/> [hereinafter *Federal Tax Reform: The Impact on States*].

¹⁴² Nicole Kaeding & Kyle Pomerleau, *Federal Tax Reform: The Impact on States*, TAX FOUNDATION (March 8, 2017), <https://taxfoundation.org/federal-tax-reform-the-impact-on-states/> [hereinafter *Federal Tax Reform: The Impact on States*].

¹⁴³ Nicole Kaeding & Kyle Pomerleau, *Federal Tax Reform: The Impact on States*, TAX FOUNDATION (March 8, 2017), <https://taxfoundation.org/federal-tax-reform-the-impact-on-states/> [hereinafter *Federal Tax Reform: The Impact on States*].

¹⁴⁴ Nicole Kaeding & Kyle Pomerleau, *Federal Tax Reform: The Impact on States*, TAX FOUNDATION (March 8, 2017), <https://taxfoundation.org/federal-tax-reform-the-impact-on-states/> [hereinafter *Federal Tax Reform: The Impact on States*].

Missouri, the taxpayers start with each of their Federal Adjusted Gross Income.¹⁴⁵ They then add in any additions and remove subtractions.¹⁴⁶ After the additions and subtractions, citizens are left with their Missouri adjusted gross income.¹⁴⁷ They are then required to calculate each spouse's percentage of the income.¹⁴⁸ Next is the application of any exemptions or deductions to the combined Missouri adjusted gross income.¹⁴⁹ Once this total amount is calculated, the couple then multiplies the total by their corresponding percentage, and calculates their individual tax from there.¹⁵⁰ Many citizens point out that this is confusing and time consuming. However, if Missouri were to adopt guidelines from other states and keep all income combined, this would shift the tax burden from single filers to married filers, since the combined income may place them in a different bracket.

Overall the Committee notes that the base is subject to many adjustments and modifications which make it complex and a less reliable revenue source than if it were a simpler base calculation that was subject to less adjustment and was more stable over time.

C. Implementation Issue: Giveaways

As with the corporate income tax, Missouri is one of only a handful of states to allow individual taxpayers to deduct their federal income tax from their state taxable income. In 2014, Missouri lost over \$679 million due to the Federal individual income tax deduction¹⁵¹. Currently, only five other states offer a deduction for federal individual income taxes paid.¹⁵² Montana is the most comparable to our deduction, with a cap of \$5,000 for single and \$10,000 for married.¹⁵³ However, the Treasure state also requires its taxpayer to itemize their state return in exchange for utilizing the Federal Income Tax Deduction.¹⁵⁴ Oregon has a cap of

¹⁴⁵ MO. REV. STAT. § 143.121 (2016).

¹⁴⁶ MO. REV. STAT. § 143.121 (2016).

¹⁴⁷ MO. REV. STAT. § 143.121 (2016).

¹⁴⁸ MO. REV. STAT. § 143.031 (1973).

¹⁴⁹ MO. REV. STAT. § 143.121 (2016).

¹⁵⁰ MO. REV. STAT. § 143.031 (1973).

¹⁵¹ *Why States That Offer the Deduction for Federal Income Taxes Paid Get it Wrong* INSTITUTE ON TAXATION AND ECONOMIC POLICY (Aug. 01, 2011), (need cite for 679 million)
<http://itep.org/why-states-that-offer-the-deduction-for-federal-income-taxes-paid-get-it-wrong/>.

¹⁵² *Why States That Offer the Deduction for Federal Income Taxes Paid Get it Wrong* INSTITUTE ON TAXATION AND ECONOMIC POLICY (Aug. 01, 2011),
<http://itep.org/why-states-that-offer-the-deduction-for-federal-income-taxes-paid-get-it-wrong/>.

¹⁵³ *Why States That Offer the Deduction for Federal Income Taxes Paid Get it Wrong* INSTITUTE ON TAXATION AND ECONOMIC POLICY (Aug. 01, 2011),
<http://itep.org/why-states-that-offer-the-deduction-for-federal-income-taxes-paid-get-it-wrong/>.

¹⁵⁴ *Why States That Offer the Deduction for Federal Income Taxes Paid Get it Wrong* INSTITUTE ON TAXATION AND ECONOMIC POLICY (Aug. 01, 2011), <http://itep.org/why-states-that-offer-the-deduction-for-federal-income-taxes-paid-get-it-wrong/>.

\$5,950, and the deduction gradually phases out for higher income earners.¹⁵⁵ Due to the more progressive federal tax rate structure, low income families are shielded from federal income taxes, and do not benefit from the state deduction of federal income taxes paid. Also, when low-and middle-income families decrease their federal tax to nearly nothing with exemptions, deductions or credits, they do not benefit from the federal income tax deduction. According to Missouri Budget Project, “more than half of the benefit of this state tax deduction goes to the top income quintile in the state.”¹⁵⁶ By eliminating the deduction, the Missouri Budget Project notes, “we could save that money and have only very modest tax increases – the average state tax increase for those in the top income quintile would be just \$482-\$532 per year.”¹⁵⁷

Additionally, Missouri is the only state to offer employers a discount for timely filing of withholding tax.¹⁵⁸ For every remittance of withholding tax that a business makes on time to the Director of Revenue, the business is allowed to retain a percentage of the total amount withheld. The percent ranges from 0.5 percent to 2 percent, depending on the amount collected.¹⁵⁹ In tax year 2016, the Missouri Department of Revenue saw a reduction in revenue of \$29 million, due to timely filing allowances for withholding.¹⁶⁰

D. Missouri Working Family Tax Credit

The Tax Reduction Act of 1975 introduced the Federal Earned Income Tax Credit (“EITC”) at the Federal level.¹⁶¹ The EITC serves as a temporary, refundable tax credit for low-income families that offset the rising costs of essential needs and other taxes.¹⁶²

According to the Internal Revenue Service, twenty-seven states and cities allow an Earned Income Tax Credit.¹⁶³ Most of these states provide a credit that is a percentage of the Earned Income Tax Credit allowed at the federal level, which ranges from 4% to 45%.¹⁶⁴ Professor Hedlund described this program as

¹⁵⁵ *Why States That Offer the Deduction for Federal Income Taxes Paid Get it Wrong* INSTITUTE ON TAXATION AND ECONOMIC POLICY (Aug. 01, 2011), <http://itep.org/why-states-that-offer-the-deduction-for-federal-income-taxes-paid-get-it-wrong/>.

¹⁵⁶ Missouri Budget Project, *supra* note 46.

¹⁵⁷ Missouri Budget Project, *supra* note 46.

¹⁵⁸ Missouri Budget Project, *supra* note 46; See MO. REV. STAT. § 143.261.1 (2016).

¹⁵⁹ See MO. REV. STAT. § 143.261.1 (2016).

¹⁶⁰ See MO. REV. STAT. § 143.261.1 (2016).

¹⁶¹ Tax Reduction Act, PL 94-12, MARCH 29, 89 Stat 26 (1975).

¹⁶² Thomas L. Hungerford & Rebecca Thless, *The Earned Income Tax Credit and the Child Tax Credit: History, Purpose, Goals, and Effectiveness*, ECONOMIC POLICY INSTITUTE (Sept. 25, 2013), <http://www.epi.org/publication/ib370-earned-income-tax-credit-and-the-child-tax-credit-history-purpose-goals-and-effectiveness/file.htm#98498573/>

¹⁶³ INTERNAL REVENUE SERVICE, STATES AND LOCAL GOVERNMENTS WITH EARNED INCOME TAX CREDIT (Dec. 7, 2016), <https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/states-and-local-governments-with-earned-income-tax-credit>.

¹⁶⁴ INTERNAL REVENUE SERVICE, STATES AND LOCAL GOVERNMENTS WITH EARNED INCOME TAX CREDIT (Dec. 7, 2016), <https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/states-and-local-governments-with-earned-income-tax-credit>.

“the most productive program to eliminate poverty.”¹⁶⁵ In his report, he says, “Unlike traditional cash assistance welfare, the Earned Income Tax Credit actually increases labor market participation.”¹⁶⁶ All but four of the twenty-seven states offer refundable tax credits.¹⁶⁷ The EITC differs from other assistance programs in that it requires the individual to work. It serves as a supplement rather than a replacement of their income.¹⁶⁸

Rod Chapel, the President of the Missouri NAACP, testified before the Committee on regarding the impact of tax policy on working class families.¹⁶⁹ He noted that the EITC relieves pressure on low income families who are working full time but are still in poverty.¹⁷⁰ Also, Mr. Chapel noted that the state should be aware of who it sought to target with the EITC. If the state seeks to benefit working families, then a per child tax credit would be most beneficial.¹⁷¹ If the state wanted to target the workforce, then it should enact an income credit.¹⁷² Provided that the EITC did not increase regressively, Mr. Chapel noted that it could be more impactful than the reduced rate on food tax or LIHTC.¹⁷³

Rod Chapel highlighted one of the reasons for potentially enacting an EITC: the potential regressivity of consumption taxes. Consumption taxes, such as sales taxes, are sometimes referred to as a regressive tax, because it will take all parties at the same rate, regardless of their income. A regressive tax means that individuals with smaller incomes will pay a larger percentage of their income into the sales tax system, than those with higher incomes. An EITC can assist the working poor with relieving some of the impact of the perceived regressivity.¹⁷⁴

In a letter to the Committee, the St. Louis Regional Chamber expressed their support for a state earned income tax credit. They noted that a state EITC is a major benefit and, “lower-income workers generally spend the credit immediately on goods and services, thus putting money back into the local economy.”¹⁷⁵ They also pointed to studies that show, “full-time work experience often translates into better job opportunities and a higher wage over time. Three out of five filers who receive the credit use it just

¹⁶⁵ Hedlund, *supra* note 18.

¹⁶⁶ Hedlund, *supra* note 18.

¹⁶⁷ INTERNAL REVENUE SERVICE, *supra* note 276.

¹⁶⁸ Thomas L. Hungerford & Rebecca Thless, *The Earned Income Tax Credit and the Child Tax Credit: History, Purpose, Goals, and Effectiveness*, ECONOMIC POLICY INSTITUTE (Sept. 25, 2013), <http://www.epi.org/publication/ib370-earned-income-tax-credit-and-the-child-tax-credit-history-purpose-goals-and-effectiveness/>.

¹⁶⁹ Rod Chapel testimony

¹⁷⁰ Rod Chapel testimony

¹⁷¹ Rod Chapel testimony

¹⁷² Rod Chapel testimony

¹⁷³ Rod Chapel testimony

¹⁷⁴ CARL DAVIS ET AL., INST. ON TAXATION & ECON. POLICY, WHO PAYS? A DISTRIBUTIONAL ANALYSIS OF THE TAX SYSTEMS IN ALL 50 STATES (5th ed. 2015), <https://itep.org/wp-content/uploads/whopaysreport.pdf>.

¹⁷⁵ Letter from Joe Reagan President and CEO, St. Louis Reg'l Chamber, to the Governor's Committee on Simple, Fair and Low Taxes.

temporarily – one or two years at a time.” Since filers who claim the credit are required to work, most only utilize the credit a few years before they have progressed in their work environment, increased their pay and no longer qualified for the earned income tax credit.¹⁷⁶ The Chamber believes “that mirroring the federal EITC allows the state to offer this tax cut to working families with the lowest possible administrative costs.”¹⁷⁷

The Center on Budget and Policy Priorities noted that an Earned Income Tax Credit at the state level expands the success of the federal credit by encouraging people to maintain employment and reduces hardships many working families and children experience. The credit is said to, “reward work and improves the outlook for children in low-income households.”¹⁷⁸

The same article identified some of the below benefits to a state earned income tax credit:

- Help working families make ends meet. This particularly works best if the credit is refundable. By making the credit refundable some low-income households will not only see a benefit of a paid tax balance, they see some of the hard earned income being returned to them. This can help boost morale and encourages the taxpayers to keep working, and may not feel they are struggling as much to meet basic needs.
- Keep families working. A big part to increasing a state’s economy is employing numerous individuals, so they in turn spend part of their income on goods. By putting the money they earned back into the state revenues, this can help boost the state’s economic outlook.
- Reduce poverty, especially among children. According to the United States Census Bureau, close to 10 million children in families with working adults, lived below the poverty line in 2015.¹⁷⁹ CBPP states, “The federal EITC is one of the nation’s most effective tools for reducing the struggles of working families and children.”¹⁸⁰

¹⁷⁶ Letter from Joe Reagan President and CEO, St. Louis Reg’l Chamber, to the Governor’s Committee on Simple, Fair and Low Taxes.

¹⁷⁷ Letter from Joe Reagan President and CEO, St. Louis Reg’l Chamber, to the Governor’s Committee on Simple, Fair and Low Taxes.

¹⁷⁸ Erica Williams, *States Can Adopt or Expand Earned Income Tax Credits to Build a Stronger Future Economy*, CENTER ON BUDGET AND POLICY PRIORITIES (Feb. 8, 2017), <http://www.cbpp.org/research/state-budget-and-tax/states-can-adopt-or-expand-earned-income-tax-credits-to-build-a> [hereinafter Williams].

¹⁷⁹ According to Census’ Current Population Survey, 9.8 million poor children had at least one working parent in 2015. 2015 CURRENT POPULATION SURVEY, UNITED STATES CENSUS BUREAU (2015), <https://www.census.gov/data/tables/time-series/demo/income-poverty/cps-pov/pov-01.html>.

¹⁸⁰ ERICA WILLIAMS, CENTER ON BUDGET AND POLICY PRIORITIES, HOW MUCH WOULD A STATE EARNED INCOME TAX CREDIT COST IN FISCAL YEAR 2018? (Feb. 8, 2017), <http://www.cbpp.org/sites/default/files/atoms/files/11-12-09sf.pdf>.

If calculated as a refundable credit at 20% of the federal credit, Missouri would see an estimated reduction in revenue of \$250 million.¹⁸¹ If calculated as a nonrefundable credit at 20% of the federal credit, Missouri would see an estimated reduction in revenue of \$63.6 million.¹⁸² If Missouri implements a Working Families Tax Credit based on the Federal EITC, approximately 515,000 working families would receive a tax credit.¹⁸³

According to Professor Hedlund's review, if Missouri were to implement an Earned Income Tax Credit, it may want to adjust some of the guidelines in place by the Federal government.¹⁸⁴ For instance, there are current stipulations around having a dependent to qualify for the credit.¹⁸⁵ Professor Hedlund recommends, "The EITC should also cover childless adults, to prevent creating unintended marriage penalties, [and] credits for low-wage workers should be split from benefits for children and benefits should be based on personal rather than family income."¹⁸⁶

E. Recommendations

Recommendation: Reform Individual Income Tax Rates to Make Them Simple, Fair and Low. Missouri's individual income tax brackets are outdated and unnecessarily numerous. Therefore, the Committee recommends restructuring the individual income tax brackets and rates as follows:

\$0.00 – \$5,000 = 1%
\$5,001 – \$10,000 = 3%
\$10,001 – \$15,000 = 4%
\$15,001 – \$20,000 = 5%
Above \$20,000 = 5.5%

Recommendation: Eliminate Missouri's Federal Income Tax Deduction. The Committee's recommendations as a whole seek to make Missouri's tax structure simple, fair and low. In keeping with that policy, the Committee recommends that Missouri join its 44 sister states and repeal the state individual income tax deduction for federal income taxes paid. Furthermore, Missouri should also join every other state in the union and repeal the timely filing discount for withholding tax. Neither one of these tax loopholes provide a material competitive advantage to Missouri's economic climate. Closing the loopholes allows for an overall rate decrease and reduction of individual income tax brackets.

¹⁸¹ ERICA WILLIAMS, CENTER ON BUDGET AND POLICY PRIORITIES, HOW MUCH WOULD A STATE EARNED INCOME TAX CREDIT COST IN FISCAL YEAR 2018? (Feb. 8, 2017), <http://www.cbpp.org/sites/default/files/atoms/files/11-12-09sfp.pdf>.

¹⁸² [Need cite]

¹⁸³ Missouri Budget Project, *supra* note 46.

¹⁸⁴ Hedlund, *supra* note 18.

¹⁸⁵ [Need cite]

¹⁸⁶ Hedlund, *supra* note __, citing (Eugene Steuerle, "EITC Expansion Backed by Obama and Ryan Could Penalize Marriage For Many Low-Income Workers": "A childless male making \$11,000 qualifies for a credit of \$1,011 under the Obama-Ryan model in 2016. If he marries a spouse with two children making about \$20,000 and getting a credit of \$5,172, they would get only ne credit of \$4,018, a loss of \$2,165 from the combined credits of \$6,273 they had before marriage."

Recommendation: Adopt a Working Family Tax Credit to Assist Missouri Families. The Committee also recommends the Legislature implement a workforce tax credit or childcare credit for working families. As Rod Chapel testified, a workforce credit would be based on income and target the economy as a whole, while a child care credit would be based on the number of children in a family. Ultimately, this decision will need to be made by the Missouri General Assembly. Either credit would spur the economy since these funds would mostly be spent in the local community.

Since the above recommendations for individual income tax all work within the existing individual income tax structure and only involve a change of the rates, adoption of a pre-modeled tax credit system and the repeal of two tax loopholes, the individual income tax changes should become effective for all tax years beginning on or after January 1 of the first year after the statute is truly agreed to and finally passed by the General Assembly and signed by the Governor.

IV. SALES TAX

Many consider consumption taxes are a much more effective avenue for collection of tax revenue than income taxes and they incentivize the behavior to be encouraged such as engagement in the labor force, maximizing earnings and savings. In fact, in most countries other than the US, significantly more emphasis is placed on consumption tax and less on income tax in raising revenue for the state. And even in the US, at the state and local level the trend is also in that direction.

A. Sales Tax Rates

Forty-five states collect statewide sales tax.¹⁸⁷ All of our eight peer states have state sales tax.¹⁸⁸ Kentucky is the only state without a local tax rate.¹⁸⁹ Of its peer states, Missouri has the lowest state tax rate of 4.225%, which is well under the national average of 6.65%.¹⁹⁰

Thirty-eight states collect local sales tax.¹⁹¹ Although Missouri has a below-average state rate, its average local tax rate is higher than most.¹⁹² The national average local tax rate is 1.81%, much lower than

¹⁸⁷ Scott Drenkard & Nicole Kaeding, *State and Local Sales Tax Rates in 2016* TAX FOUNDATION. March 9, 2016 <https://taxfoundation.org/state-and-local-sales-tax-rates-2016/> [hereinafter Drenkard & Kaeding].

¹⁸⁸ Scott Drenkard & Nicole Kaeding, *State and Local Sales Tax Rates in 2016* TAX FOUNDATION. March 9, 2016 <https://taxfoundation.org/state-and-local-sales-tax-rates-2016/> [hereinafter Drenkard & Kaeding].

¹⁸⁹ Scott Drenkard & Nicole Kaeding, *State and Local Sales Tax Rates in 2016* TAX FOUNDATION. March 9, 2016 <https://taxfoundation.org/state-and-local-sales-tax-rates-2016/> [hereinafter Drenkard & Kaeding].

¹⁹⁰ Scott Drenkard & Nicole Kaeding, *State and Local Sales Tax Rates in 2016* TAX FOUNDATION. March 9, 2016 <https://taxfoundation.org/state-and-local-sales-tax-rates-2016/> [hereinafter Drenkard & Kaeding].

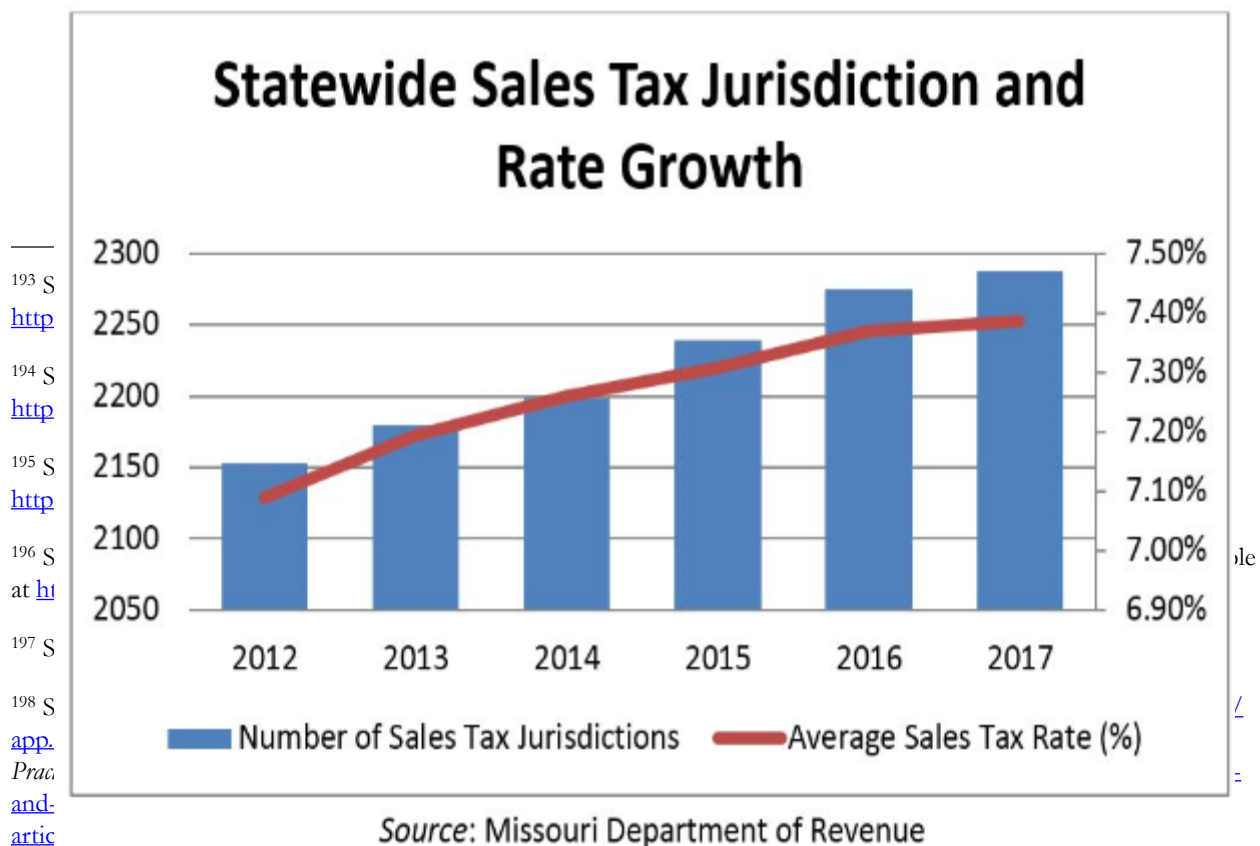
¹⁹¹ Scott Drenkard & Nicole Kaeding, *State and Local Sales Tax Rates in 2016* TAX FOUNDATION. March 9, 2016 <https://taxfoundation.org/state-and-local-sales-tax-rates-2016/> [hereinafter Drenkard & Kaeding].

¹⁹² Scott Drenkard & Nicole Kaeding, *State and Local Sales Tax Rates in 2016* TAX FOUNDATION. March 9, 2016 <https://taxfoundation.org/state-and-local-sales-tax-rates-2016/> [hereinafter Drenkard & Kaeding].

Missouri's average of 3.64%.¹⁹³ Missouri has the second highest average local tax rate compared to its peers, trailing only Oklahoma, who has a 4.23% average local tax rate. ¹⁹⁴ According to a study by The Tax Foundation, only 13 states have higher state and local state tax rates than Missouri.¹⁹⁵

Currently, the state of Missouri does little to limit the nearly 2,300 local sales tax jurisdictions that complicated the state's overall sales tax environment. Local sales tax burden ranges from a low of 4.725% in Clinton and St. Clair Counties to highs of 10.863% in Woodson Terrace (a municipality in St. Louis County) and 10.679% in parts of the City of St. Louis.¹⁹⁶ A myriad of local sales tax rates, Tax Increment Financing districts ("TIFs"), Transportation Development Districts ("TDDs"), and Community Improvement Districts ("CIDs") add onto the State sales tax to place an ever-increasing burden on Missouri citizens and businesses. Concurrent with the growth of these various tax jurisdictions, Missouri's average sales tax rate has risen from 7.1% to nearly 7.4% over the past 5 years.¹⁹⁷ Raising further concern, some of Missouri's special sales tax districts have been criticized of corruption, conflicts of interest, and poor accountability to taxpayers.¹⁹⁸

Figure 15: Statewide Sales Tax Jurisdiction and Rate Growth¹⁹⁹



¹⁹⁹ Show-Me Institute (February 16, 2017), available at <http://showmeinstitute.org/blog/local-government/missouri%E2%80%99s-troubling-sales-tax-mosaic>.

B. Sales Tax Base

More than 200 sales and use tax exemptions or exclusions have eroded Missouri's tax base since they were first implemented in 1939.²⁰⁰ Most exemptions costs are not easily tracked within the Department of Revenue. However, in Fiscal Year 2016, Missouri saw total state revenue losses of \$4.5 million for the exemption of textbooks and \$55.8 million for one of many manufacturing exemptions.²⁰¹

Most states with a sales tax exempt certain groceries. Currently, six states including Missouri offer groceries at a reduced sales tax rate.²⁰² Only seven states currently tax food at the same rate as other sales tax transactions.²⁰³ However, four of those states (Oklahoma, Kansas, Hawaii, and Idaho), offer a credit or rebate to offset some of the taxes paid on groceries.²⁰⁴

Missouri food tax exemption bill was introduced in 1997. The statute was amended in 1999, to include the statement, "...except for vending machine sales, the term "food" shall not include food or drink sold by any establishment where the gross receipts derived from the sale of food prepared by such establishment for immediate consumption on or off the premises of the establishment constitutes more than eighty percent of the total gross receipts of that establishment," such as restaurants.²⁰⁵

In the first year of implementation, Missouri saw a reduction in revenue of a little under \$134 million.²⁰⁶ This amount increased each year until Fiscal Year 2001, when it decreased.²⁰⁷ We attribute this

²⁰⁰ Donald Phares, *Examining Missouri's Tax System: Tax Expenditures-A First Step* (April 2003) (prepared for Mo. Dep't of Revenue), <http://mobudget.org/files/intro.pdf>; "Missouri Sales and Use Tax Exemptions and Exclusions from Tax," Missouri Department of Revenue, <http://dor.mo.gov/business/sales/sales-use-exemptions.php>

²⁰¹ OVERSIGHT DIVISION, PROGRAM EVALUATION: MO. DEP'T OF REVENUE STATE SALES TAX EXEMPTION (2010), <http://www.moga.mo.gov/oversight/over09/pdfs/revenue%20sales%20tax%20exemptions.0150i.arc.pdf> [hereinafter PROGRAM EVALUATION].

²⁰² Eric Figueroa & Samantha Waxman, *Which States Tax the Sales of Food For Home Consumption in 2017?*, CENTER ON BUDGET AND POLICY PRIORITIES. March 1, 2017, <http://www.cbpp.org/research/state-budget-and-tax/which-states-tax-the-sale-of-food-for-home-consumption-in-2017>.

²⁰³ Eric Figueroa & Samantha Waxman, *Which States Tax the Sales of Food For Home Consumption in 2017?*, CENTER ON BUDGET AND POLICY PRIORITIES. March 1, 2017, <http://www.cbpp.org/research/state-budget-and-tax/which-states-tax-the-sale-of-food-for-home-consumption-in-2017>.

²⁰⁴ Eric Figueroa & Samantha Waxman, *Which States Tax the Sales of Food For Home Consumption in 2017?*, CENTER ON BUDGET AND POLICY PRIORITIES. March 1, 2017, <http://www.cbpp.org/research/state-budget-and-tax/which-states-tax-the-sale-of-food-for-home-consumption-in-2017>.

²⁰⁵ MO. REV. STAT. § 144.014 (2016).

²⁰⁶ Email from Joel Allison, Deputy Director of Taxation, to Todd Iveson, Director of Taxation (April 18, 2017).

²⁰⁷ Email from Joel Allison, Deputy Director of Taxation, to Todd Iveson, Director of Taxation (April 18, 2017).

decrease to the beginning of the recession in early 2000s.²⁰⁸ In Fiscal Year 2016, Missouri saw a general revenue loss of over \$406 million, due to the reduced tax rate for food.²⁰⁹

Missourians voted for Amendment 4 on the November 8, 2016 ballot which amended the state constitution to place limitations on the expansion of sales tax base. Amendment 4 prevents the Missouri General Assembly from levying a sales or use tax (or any other similar transaction based tax) on any service or transaction that was not subject to sales, use or any other similar transaction based tax before January 1, 2015.²¹⁰ Thus, any consideration of reform of the sales tax regime in Missouri must take into account this restriction.

C. Sales Tax Gaps: Vendor Discount

Much like the withholding tax timely filing discount discussed in the Income Tax section of this report, Missouri also provides a 2% sales tax timely filing discount for vendors who remit sales tax collected.²¹¹ According to Missouri Revised Statute 144.140.1, “from every remittance to the director of revenue made on or before the date when the same becomes due, the person required to remit the same shall be entitled to deduct and retain an amount equal to two percent thereof.”²¹² In short, if a business collects sales or use tax, and timely remits that tax to the Department, then that business may retain two percent of the tax it remitted. In Fiscal Year 2016, sales tax revenue was reduced by approximately \$115 million (about \$56 million in state revenues, and \$59 million in local revenues).²¹³ In the same year, withholding tax revenue was reduced by approximately \$29 million.²¹⁴

Twenty-eight states provide a vendor discount for sales tax, including 5 of our peer states.²¹⁵ However, many of these states include a cap for the amount claimed per month or year. For example, Illinois only allows \$5 per year and Oklahoma offers \$2,500 per month.²¹⁶ “With the exception of Colorado, all states that have higher vendor discount rates than Missouri either cap the total dollar amount that companies can retain, or apply the higher rate to a limited dollar amount. For example, Georgia provides a three percent vendor discount, but only to the first \$3,000 of sales tax collected.”²¹⁷

²⁰⁸ I do not have an email or a fact to point this to. I believe it was said by Todd or Joel Allison. Either way, not a fact and should probably be removed.

²⁰⁹ Email from Michael Harris, Taxation Legislative Coordinator, to Kayla Jeffers (May 31, 2017) (on file with author).

²¹⁰ MO. CONST. ART. X §26.

²¹¹ MO. REV. STAT. § 144.140.1 (2016).

²¹² MO. REV. STAT. § 144.140.1 (2016).

²¹³ MO. DEPT OF REV. FINANCIAL AND STATISTICAL REPORT, *supra* note 70.

²¹⁴ MO. DEPT OF REV. FINANCIAL AND STATISTICAL REPORT, *supra* note 70.

²¹⁵ MO. DEPT OF REV. FINANCIAL AND STATISTICAL REPORT, *supra* note 70.

²¹⁶ MO. DEPT OF REV. FINANCIAL AND STATISTICAL REPORT, *supra* note 70.

²¹⁷ Missouri Budget Project, *supra* note 46.

In 2016, the Missouri Department of Revenue gathered data related to the limitations of timely filing discounts for sales and use tax. The Missouri Department of Revenue queried what the savings to the state would be if we were to place a cap on the amount a taxpayer could claim in a given month or year. Below are some of the findings from the study:

- A cap of \$1,500 per month results in \$58.6 million savings annually
- A cap of \$2,500 per month results in \$51.6 million savings annually
- A cap of \$1,500 per year results in \$90.8 million savings annually
- A cap of \$2,500 per year results in \$84 million savings annually
- A cap of \$18,000 per year results in \$57.5 million savings annually
- A cap of \$30,000 per year results in \$50.6 million savings annually

D. Sales Tax Gaps: Out of State Vendors

With the continued growth of Internet sales, many states are attempting to tax such sales through business entities taxes, such that the states can tax out of state sellers.²¹⁸ Every state in the nation is hamstrung by the 1992 US Supreme Court decision, *Quill Corp. v. North Dakota*. In *Quill*, the US Supreme Court held that physical presence was required for an out of state seller to have substantial nexus with a taxing state as required by the Commerce Clause of the US Constitution.²¹⁹ As a result, states may not collect use tax from remote sellers who do not have physical presence in that state.²²⁰ According to the National Conference of State Legislatures, “states lost an estimated \$23.3 billion in 2012 from being prohibited from collected sales tax from online and catalog purchase.”²²¹ Missouri was specifically listed as reducing revenues by \$210.7 million, due to uncollected use tax on electronic business to business and business to customer transactions.²²²

States are taking a number of approaches in this area, including challenging the current nexus standard with bills economic nexus standards, changing the reporting requirements, challenging *Quill* in state and federal court and entering into compacts while waiting for Congress to act.

E. Economic Nexus Bills

²¹⁸ Cline, *supra* note 19.

²¹⁹ *Quill Corp. v. North Dakota*, 504 U.S. 298, 311 (1992).

²²⁰ *Quill Corp. v. North Dakota*, 504 U.S. 298, 311 (1992).

²²¹ *Collecting E-Commerce Taxes: E-Fairness Legislation*, NATIONAL CONFERENCE OF STATE LEGISLATURES, Nov. 14, 2014 <http://www.ncsl.org/research/fiscal-policy/collecting-ecommerce-taxes-an-interactive-map.aspx>.

²²² *Collecting E-Commerce Taxes: E-Fairness Legislation*, NATIONAL CONFERENCE OF STATE LEGISLATURES, Nov. 14, 2014 <http://www.ncsl.org/research/fiscal-policy/collecting-ecommerce-taxes-an-interactive-map.aspx>.

In 2017, 35 bills were introduced in 17 states to challenge the decision of *Quill v. North Dakota*.²²³ As taxpayers increasingly utilize online purchasing, states are looking for ways around the decision to implement taxation of remote sellers. Indiana is attempting to implement an Economic Nexus Bill that would establish a bright line sales threshold; if sellers exceed the amount, they are considered to have nexus in the state to report and collect sales tax.²²⁴ These thresholds are established as a specific dollar amount, number of transactions, or both. For instance, in Ohio, a business is generally considered to have Nexus for the Commercial Activity Tax, if they have more than \$150,000 in taxable gross receipts in a calendar year.

However, Ohio has recently become the first state to expand its nexus standard to include remote sellers.”²²⁵ There have been multiple states that have implemented or attempted to implement a similar standard, by creating a substantial nexus requirement to comply with the U.S. Supreme Court’s ruling in *Complete Auto v. Brady*.²²⁶ In Ohio, a taxpayer will establish economic nexus with the Buckeye state if he owns \$50,000 in Ohio property, pays \$50,000 in Ohio payroll, earns \$500,000 in taxable gross receipts; or has at least 25% of the person’s total property, total payroll, or total taxable gross receipts within the state.²²⁷

South Dakota has adopted a standard of their own, with Senate Bill 106.²²⁸ A taxpayer may establish nexus with South Dakota if its sales into South Dakota exceed \$100,000 or the taxpayer has more than 200 separate transactions in South Dakota.”²²⁹ This bill is currently being challenged before the South Dakota Supreme Court.²³⁰

²²³ Joe Crosby, *Economic Nexus is the Most Prevalent Type of Sales Tax Compliance Legislation This Year*, MULTISTATE INSIDER (Jan. 27, 2017), <https://www.multistate.us/blog/economic-nexus-is-the-most-prevalent-type-of-sales-tax-compliance-legislation-this-year>.

²²⁴ Tom Chrzanowski & Mo Bell-Jacobs, *Indiana enacts economic sales tax nexus provisions*, RSM. May 3, 2017, <http://rsmus.com/what-we-do/services/tax/state-and-local-tax/sales-and-use-tax/indiana-enacts-economic-sales-tax-nexus-provisions.html>.

²²⁵ *State Business Tax Reform: Presentation to Missouri Governor’s Committee for Simple, Fair and Low Taxes*, Governor’s Committee for Simple, Fair and Low Taxes (May 15, 2017).

²²⁶ *State Business Tax Reform: Presentation to Missouri Governor’s Committee for Simple, Fair and Low Taxes*, Governor’s Committee for Simple, Fair and Low Taxes (May 15, 2017).

²²⁷ *State Business Tax Reform: Presentation to Missouri Governor’s Committee for Simple, Fair and Low Taxes*, Governor’s Committee for Simple, Fair and Low Taxes (May 15, 2017).

²²⁸ 2016 Senate Bill 106: Remote Seller Compliance, S.D. DEP’T OF REVENUE, http://dor.sd.gov/Taxes/Business_Taxes/SB106.aspx (last visited June 16, 2017). *South Dakota Enacts S.B. 106: Physical Presence No Longer Required for Sales Tax Collection*, DELOITTE: EXTERNAL MULTISTATE TAX ALERT March 30, 2016 <https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-mts-alert-south-dakota-enacts-sb-106-physical-presence-no-longer-required-for-sales-collection.pdf>.

²²⁹ *South Dakota Enacts S.B. 106: Physical Presence No Longer Required for Sales Tax Collection*, DELOITTE: EXTERNAL MULTISTATE TAX ALERT March 30, 2016 <https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-mts-alert-south-dakota-enacts-sb-106-physical-presence-no-longer-required-for-sales-collection.pdf>.

²³⁰ Need cite

Some of the other states who currently have a bill in legislation, or one that has been approved are Alabama, Louisiana, Massachusetts, and Wyoming.²³¹ Georgia and Mississippi had *Quill* challenge bills that did not pass the legislature.²³²

F. Reporting Requirement Bills

Colorado took a different approach to its *Quill* challenge. In 2010, the Centennial state passed a bill which “requires retailers that sell to Colorado customers, but do not collect and remit Colorado use tax, to report certain information about such purchases to the customers and to the Colorado DOR. Such retailers must:

- Notify Colorado customers that the retailer does not collect Colorado sales tax and, therefore the customer is obligated to self-report and pay use tax to the DOR.
- Provide each of their Colorado customers an annual report detailing that customer’s purchases from the retailer in the previous calendar year, including a notice that the customer is obligated to pay use tax and that the retailer is obligated to report the customer’s name and purchases to the DOR. This requirement applies only to customers who spend more than \$500 with the retailer in a calendar year.
- Provide the DOR with an annual report, which included customers’ names and total purchases from the retailer. This requirement applies only to retailers with \$100,000 or more of Colorado gross annual sales.²³³

Reporting was scheduled to begin January 31, 2011.”²³⁴ In January 2011, Direct Marketing Association (DMA) challenged the notice and reporting law.²³⁵ [insert description of the case’s result]

F. Streamlined Sales Tax State

²³¹ *South Dakota Enacts S.B. 106: Physical Presence No Longer Required for Sales Tax Collection*, DELOITTE: EXTERNAL MULTISTATE TAX ALERT March 30, 2016 <https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-mts-alert-south-dakota-enacts-sb-106-physical-presence-no-longer-required-for-sales-collection.pdf>; I was incorrect on this one. It was enacted in 2016. Thank goodness for your team checking! <https://www.legis.la.gov/legis/BillInfo.aspx?i=228628> according to this, it was signed by the Governor 3/14/2016 and states “**Provides for the collection of sales and use taxes due on sales made in Louisiana by a remote dealer (Item #30) (EN SEE FISC NOTE GF RV See Note)**”

²³² *HB 61, Probate Court*, GEORGIA GENERAL ASSEMBLY, <http://www.legis.ga.gov/Legislation/en-US/display/20152016/HB/61> (last visited June 15, 2017); *Mississippi House Bill 480, Summary*, LEGISCAN, <https://legiscan.com/MS/bill/HB480/2017> (last visited June 6, 2017).

²³³ Need cite

²³⁴ *Tax Insights from State and Local Tax Services. Colorado – Use Tax Notice and Reporting Law Upheld, No Discrimination Against or Undue Burden on Interstate Commerce*, PRICEWATERHOUSECOOPERS, February 25, 2016, <http://www.pwc.com/us/en/state-local-tax/newsletters/salt-insights/colorado-use-tax-reporting-law-upheld-no-burden-on-interstate-co.html>.

²³⁵ *Tax Insights from State and Local Tax Services. Colorado – Use Tax Notice and Reporting Law Upheld, No Discrimination Against or Undue Burden on Interstate Commerce*, PRICEWATERHOUSECOOPERS, February 25, 2016, <http://www.pwc.com/us/en/state-local-tax/newsletters/salt-insights/colorado-use-tax-reporting-law-upheld-no-burden-on-interstate-co.html>.

Another avenue states have taken to collect tax on remote sellers is by becoming a Streamlined Sales Tax state. The Marketplace Fairness Act of 2015 (“MFA 2015”) is the multistate agreement for the administration and collection of sales and use taxes adopted on November 12, 2002. MFA 2015, “authorizes each member under the Streamlined Sales and Use Tax Agreement (“Agreement”) to require all sellers not qualifying for a small-seller exception (applicable to sellers with annual gross receipts in total U.S. remote sales not exceeding \$1 million) to collect and remit sales and use taxes with respect to remote sales under provisions of the Agreement, but only if such Agreement includes minimum simplification requirements relating to the administration of the tax, audits, and streamlined filing.”²³⁶ MFA 2015 aims to allow states to collect sales and use tax from remote sellers without physical presence in that state.²³⁷

The Streamlined Sales Tax Governing Board was created to “administer and operate the Streamlined Sales and Use Tax Agreement as Amended.”²³⁸ The Streamlined Sales Tax Governing Board “may take any action that is necessary and proper to fulfill the purposes of the Agreement.”²³⁹ According to the Streamlined Sales Tax Governing Board, the “Agreement is the result of the cooperative effort of 44 states, the District of Columbia, local governments and the business community to simplify sales and use tax collection and administration by retailers and states.

The Agreement minimizes costs and administrative burdens on retailers that collect sales tax, particularly retailers operating in multiple states. It encourages “remote sellers” selling over the Internet and by mail order to collect tax on sales to customers living in Streamlined states. It levels the playing field so that local “brick-and-mortar” stores and remote sellers operate under the same rules. This Agreement ensures that all retailers can conduct their business in a fair, competitive environment.”²⁴⁰

Twenty-three states fully comply with the Streamlined Sales and Use Tax Agreement, including six of our contiguous states (Kansas, Nebraska, Iowa, Kentucky, Arkansas, and Oklahoma).²⁴¹ Tennessee is an associate member of the Streamlined Sales and Use Tax Agreement, meaning they have achieved substantial compliance with the terms of the Agreement as a whole, but not necessarily each provision.²⁴² Illinois is the only neighboring state that does not comply in some way with the Agreement. The MFA which was

²³⁶ S.R. 698, 11th Cong., 1st Sess. (2015-16).

²³⁷ *Multistate Tax: State Tax Matters* DELOITTE. April 10, 2015, <https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-statetaxmatters-150410.pdf>.

²³⁸ STREAMLINED SALES TAX GOVERNING BOARD, INC. BYLAWS (last amended May 24, 2012), http://www.streamlinedsalestax.org/uploads/downloads/Bylaws/SST%20Bylaws%20%20Updated%20through%2010_30_13%20-%20Revised%2012_26_13.pdf

²³⁹ Bylaws of the Streamlined Sales Tax Governing Board, Inc. Last Amended 24 May 2012. http://www.streamlinedsalestax.org/uploads/downloads/Bylaws/SST%20Bylaws%20%20Updated%20through%2010_30_13%20-%20Revised%2012_26_13.pdf

²⁴⁰ *FAQ: What Is the Streamlined Sales and Use Tax Agreement*, STREAMLINED SALES TAX GOVERNING BOARD, INC., <http://www.streamlinedsalestax.org/index.php?page=gen1> (last visited June 12, 2017).

²⁴¹ *FAQ: What Is the Streamlined Sales and Use Tax Agreement*, STREAMLINED SALES TAX GOVERNING BOARD, INC., <http://www.streamlinedsalestax.org/index.php?page=gen1> (last visited June 12, 2017).

²⁴² *Streamlined Sales Tax*, TENN. DEP’T OF REVENUE, <https://www.tn.gov/revenue/article/streamlined-sales-tax> (last visited June 15, 2017).

introduced in 2013 and a similar bill in 2015 would only authorize the member states of the Agreement to collect sales tax from “remote sellers.”²⁴³ The only time the MFA would apply to a non-member state, is if they adopted certain “minimum simplifications requirements,” such as Tennessee.²⁴⁴

A study completed by the University of Missouri, estimated Missouri saw a decrease in state and local revenue in 2014 of approximately \$358.3 million.²⁴⁵

H. Recommendations

Recommendation: Simplify and Lower the State Sales Tax Rate.

- The Committee recommends adopting one sales tax rate of 4%, by eliminating all exemptions, with two exceptions:
 - First, the sale of groceries would be taxed at 1% and that special sales tax rate would expire without legislative action after five years.
 - Second, Business to business sales would be exempt from sales tax, if the sale was of a part used in directly creating a product that will ultimately be sold at retail. The committee acknowledges that the lack of exemptions and exclusions would compel some residents to cross state lines to purchase goods.

Recommendation: Repeal the 2% vendor discount.

- This is an outdated tax loophole in which the state provides a financial inducement for following the law. Missouri does not provide a cash rebate for driving under the speed limit and should not provide a benefit for the legally mandated collection of sales and use tax.

Recommendation: Impose a Cap on Sales Tax Rates Throughout Missouri.

- Missouri’s many sales tax jurisdictions and rates are confusing, complicated, and regressive, and their growth over recent years should cause concern. A statutory sales tax cap could mirror Missouri’s “Mack’s Creek Law”, which places a cap on the amount of revenue that municipalities can generate from traffic tickets.
 - Mack’s Creek Law requires that any traffic ticket revenue collected by a municipality over a statutorily-set percentage of the municipality’s annual revenue be remitted to Missouri’s general revenue, thus curbing municipalities’ incentives to exploit traffic tickets as a disproportionate source of revenue.
- The Committee also recommends that the General Assembly introduce stability and certainty to the State’s sales taxes by capping the overall sales tax rate at 12%, including any add-on sales taxes imposed by TIFs, TDDs, and CIDs.

Recommendation: Adopt an Economic Nexus Standard to Collect Unpaid Sales Tax.

²⁴³ <http://www.streamlinedsalestax.org/> and <http://marketplacefairness.org/questions-and-answers/> the marketplace fairness act website has an FAQ asking about small businesses, here it refers to online sales and remote sales. *Streamlined Sales Tax*, TENN. DEP’T OF REVENUE, <https://www.tn.gov/revenue/article/streamlined-sales-tax> (last visited June 15, 2017).

²⁴⁴ *Streamlined Sales Tax*, TENN. DEP’T OF REVENUE, <https://www.tn.gov/revenue/article/streamlined-sales-tax> (last visited June 15, 2017).

²⁴⁵ Missouri Budget Project, *supra* note 46.

- The Committee recommends adopting an economic nexus standard to capture this unpaid tax. The suggested requirements would be similar to South Dakota. It is recommended to enact legislation that requires sales tax be collected and remitted to the Missouri Department of Revenue, if an entity has annual sales exceeding \$100,000 or they have 200 separate transactions within the state.

Recommendation: Missouri Should Join the Streamlined Sales Tax Agreement.

- Admission to the group of states who have adopted this Agreement would ease Missouri's transition into collecting sales and use tax from remote sellers, should Congress pass the current iteration of the MFA.

V. TAX ADMINISTRATION

While not the most critical driver of the overall tax environment, the administration of the tax system is one factor that is considered when looking at the overall tax environment for business and citizens of the State. It is therefore, an important consideration and one in which changes may be possible without legislative action and therefore easier to implement.

This area is not considered a material weakness of the State. However, in the course of its deliberations the Committee identified a number of areas for consideration that it believes could enhance the overall tax regime and environment in Missouri.

A. Taxpayer Bill of Rights

Like many states and the federal government, Missouri currently has a Taxpayer Bill of Rights. Section 136.355, RSMo requires the Director of Revenue to "compile a statement" which is then reflected the Department of Revenue publication, Form 3097.

State and federal implementation varies widely. Some states have one to two page documents with broad descriptions of rights. Others, like Missouri, have multi-page documents much are more descriptive content. A few states require a simple form to be included in all taxpayer correspondence.

B. State Regulations

One common idea heard in testimonies and town halls is the use of state regulations. On January 10, 2017, Governor Greitens issued Executive Order 17-03, stating:

"the Missouri Register, a publication that included proposed and final regulations, has published more than 40,000 pages since 2000, and Missourians and Missouri business businesses deserve efficient, effective, and necessary regulations and regulations should not reduce jobs, stifle entrepreneurship, limit innovation, or impose costs far in excess of their benefits; and regulations that are ineffective, unnecessary, or unduly burdensome must be repealed; and removing needless and burdensome regulations will make Missouri more attractive to businesses and encourage job growth. NOW THEREFORE, I, ERIC R. GREITENS, GOVERNOR OF THE STATE OF MISSOURI, by virtue of the authority vested in me by the Constitution and laws of the State of Missouri, do hereby order: 1. Every State Agency shall immediately suspend all rulemaking."²⁴⁶

The order goes on to say state agencies should review all regulations and repeal or to cease rulemaking for any regulation that does not meet certain criteria.

²⁴⁶ Exec. Order No. 17-07, *supra* note 2.

The Committee understands that the Missouri Department of Revenue needs to review all regulations and repeal any that may no longer be applicable. However, they also believe, tax regulations can be beneficial to taxpayers to provide explanation to unclear statutes and in light of the public comment the consideration of using more regulations to provide clarity and certainty is an option.

C. State Tax Appeal Process

Doug Lindholm recommended that Missouri improve state tax appeals and procedural requirements.²⁴⁷ COST routinely evaluates states on their statutes, rules and practices, and how they influence the taxpayer's rights to an independent appeals system.²⁴⁸ The last evaluation was published in December 2016, and Missouri received a B grade.²⁴⁹

Below are Mr. Lindholm's recommendations to improve Missouri's appeals and procedural requirements:²⁵⁰

- *“Independent appeals forum.* While Missouri's Administrative Hearings Commission is an independent agency, its commissioners are not required to have tax expertise (and appear generally not to possess such expertise). Further, the Commission hears all types of executive agency appeals. To ensure the requisite expertise to handle complex tax appeals, COST recommends that independent tax tribunal judges have significant state tax experience, and the tribunal should dedicate those tax tribunal judges to deciding tax appeals.
- *Timing of appeals.* Taxpayers have 60 days after mailing date to protest a notice of deficiency however; they only have 30 days from the mailing date to appeal a final income tax decision of the Department of Revenue to the Administrative Hearing Commission. As with protests of assessments, taxpayers should have at least 60 days from the actual receipt of a determination to appeal an adverse final decision of the Department of Revenue to an independent tribunal.
- *Interest rate differential.* While Missouri's interest rates on tax refunds and underpayments previously were the same, since 2004 there has been a differential in the interest rate applied to refunds versus tax deficiencies. The statutory rate of interest applied to refunds is the annualized average rate on funds invested by the Treasurer's Office, whereas the rate applied to underpayments is the prime rate. For 2017, the resulting interest rate applied to refunds is less than one percent per quarter, while the rate on tax deficiencies is 4%. In addition to this disparity, interest on refund claims begins from the date a claim is filed and not the date the tax was overpaid. In contrast, interest on tax deficiencies starts from the original payment due date. For business taxes, no interest is paid if the refund is issued within 120 days of filing the return or the claim. Interest rates are meant to compensate for the time-value of money, and the rate (and its application) should be equal for both refunds and tax deficiencies.
- *Reporting of federal changes.* COST supports clear and consistent rules for determining when a “final determination” of a federal income tax audit triggers a reporting requirement to a state. The

²⁴⁷ Lindholm, *supra* note 82.

²⁴⁸ DOUGLAS L. LINDHOLM ET AL., COST, THE BEST AND WORST OF STATE TAX ADMINISTRATION: COST SCORECARD ON TAX APPEALS & PROCEDURAL REQUIREMENTS (Dec. 2016), <http://www.cost.org/WorkArea/DownloadAsset.aspx?id=94726>.

²⁴⁹ DOUGLAS L. LINDHOLM ET AL., COST, THE BEST AND WORST OF STATE TAX ADMINISTRATION: COST SCORECARD ON TAX APPEALS & PROCEDURAL REQUIREMENTS (Dec. 2016), <http://www.cost.org/WorkArea/DownloadAsset.aspx?id=94726>.

²⁵⁰ Lindholm, *supra* note 82.

reporting requirement should only require a taxpayer to file one return after the audit is truly final (i.e., all appeals exhausted). A taxpayer should also be able to make estimated payments to address a potential tax deficiency, while preserving the taxpayer's right to a refund. COST urges a review of Missouri's regulatory definition of "final determination" against these standards. COST also supports providing at least six months (or 180 days) to file an amended return or worksheet to the state to notify it of the changes. Missouri currently requires reporting a final determination within 90 days.

- *Additional issues impacting fair and efficient tax administration:*
 - New issues to support claims for refund may not be raised at the Administrative Hearing Commission. Because the Commission is the first level of review by an independent tax tribunal, taxpayers should be allowed to raise new issues to the Commission.
 - Constitutional issues must be raised at the Commission level, even though the Commission may not decide those issues. COST recommends allowing taxpayers to raise constitutional issues on appeals of Commission decisions, even if those issues were not raised by the taxpayer before the Commission.²⁵¹

D. Tax Advisory Committee

Several states have instituted a Tax Advisory Committee made up of economists, business groups, consumer groups and groups representing various levels of wage earners. The committee gives the Governor and others an ongoing capability of getting input both internally within the group and externally with town halls or social media interactions.

Some state committees are perennial, with appointment terms for the members, and meet several times a year. Others meet occasionally, as much as every five years, and may have different members appointed for each "session."

E. Taxpayer Advocate and Assistance Offices

Missouri, along with several other states, has an Office of Taxpayer Advocate established in RSMo 37.650. The position is appointed by the governor, serves for six years, and is required to report yearly to the governor and general assembly. The previous governor did not appoint a Taxpayer Advocate and the position remains empty.

Up until 2015, Missouri maintained Taxpayer Assistance Offices in St. Louis, Kansas City, Springfield, St. Joseph, Joplin, Cape Girardeau, and Jefferson City. Those offices were closed due to budget cuts.

VI. IMPACT OF FEDERAL TAX LEGISLATION

It is too early to react to actions at the Federal level. However, one-party control of the Legislative and Executive Branches makes comprehensive tax reform more likely. Federal actions need to be closely monitored as Missouri pursues its own tax reform.

²⁵¹ Lindholm, *supra* note 82.

For example, were Congress to enact President Trump's plan to increase the standard deduction,²⁵² then Missouri could lose a significant amount of tax revenue since Missouri bases its calculations off of Federal AGI. Both President Trump and Speaker of the House Paul Ryan have proposed competing plans for tax reform. Both plans would reduce the amount of federal revenue over the next 10 years and therefore need to be monitored from a state tax standpoint.

Missouri is currently a rolling conformity state, meaning that it adopts the Internal Revenue Code changes as they occur.²⁵³ Eighteen states operate this way.²⁵⁴ Twenty states implement a static conformity, meaning they adopt the Internal Revenue Code changes as of a specific date.²⁵⁵ For instance, Massachusetts' individual conformity is static from January 1, 2005.²⁵⁶ Of the seven contiguous states that apply an individual income tax, four have rolling conformity, two have static conformity, and Arkansas does not conform to the Internal Revenue Code.²⁵⁷

However, if Missouri chooses to decouple from federal law, state revenues will no longer be dependent on federal tax reform. This may burden the taxpayer with additional work in order to file a return with Missouri. Separating from the Internal Revenue Code, may also increase state's cost to administering the tax. Currently, because Missouri can rely on the federal decision of adjusted gross income, there is not a need to conduct these kinds of audits. Yet, if Missouri were to break ties to federal law, individual audits would be necessary to ensure compliance. This would in turn cost the state for additional employees and training.

VII. FUEL TAX

To become a best-in-class state, Missouri must have high-quality infrastructure that connects the dots between people and businesses. Paradoxically, Missouri has the nation's 7th largest state highway system, but the 4th lowest funding per mile.²⁵⁸ Missouri also has the 6th most bridges of any state.²⁵⁹ Typically, bridges must be replaced every 50 years; Missouri's current transportation funding levels set state bridge replacement pace at 200 years.²⁶⁰ At Missouri's current infrastructure funding levels, the State cannot properly maintain its

²⁵² *Federal Tax Reform: The Impact on States*, *supra* note 254.

²⁵³ *Federal Tax Reform: The Impact on States*, *supra* note 254.

²⁵⁴ *Federal Tax Reform: The Impact on States*, *supra* note 254.

²⁵⁵ *Federal Tax Reform: The Impact on States*, *supra* note 254.

²⁵⁶ *Federal Tax Reform: The Impact on States*, *supra* note 254.

²⁵⁸ See MO. DEP'T OF TRANS., CITIZEN'S GUIDE TO TRANSPORTATION FUNDING IN MISSOURI: RESULTS SUMMARY 2007-2016 (Nov. 2016) at 3 [hereinafter, "MODOT Guide"].

²⁵⁹ See MO. DEP'T OF TRANS., CITIZEN'S GUIDE TO TRANSPORTATION FUNDING IN MISSOURI: RESULTS SUMMARY 2007-2016 (Nov. 2016) at 10 [hereinafter, "MODOT Guide"].

²⁶⁰ Patrick McKenna, *Testimony before the Governor's Committee for Simple, Fair, and Low Taxes* (May 30, 2017) [hereinafter "McKenna Testimony"].

roads and bridges. Missouri falls short by \$170 million per year for high-priority maintenance needs and \$300 million per year for necessary major interstate reconstruction.²⁶¹

Missouri's infrastructure revenue comes from a combination of State consumption fees, federal funding, and appropriations from the General Assembly. Nearly two-thirds of Missouri's infrastructure revenue is generated through consumption fees such as fuel tax and license registration fees.²⁶² Combined with federal transportation-related fees, the average Missouri driver pays about \$30 per month to use the State's vast system of roads and bridges.²⁶³ The largest source of revenue from Missouri's consumption fees comes from the State gas tax of \$0.17 per gallon of gasoline.²⁶⁴ However, Missouri's fuel tax rate was set in 1996 and holds less than half of the purchasing power it had twenty years ago due to inflated prices of steel, concrete, and asphalt over the same period.²⁶⁵

Compared to its peer states, Missouri lags behind in infrastructure funding. Missouri's funding amounts to slightly more than \$50,000 per mile of state-maintained highway, less than one fourth of the national average and lower than all but one of Missouri's border states.²⁶⁶ Additionally, Missouri has a lower fuel tax rate than every border state except Oklahoma (see Figure 1.X below), which generates a significant portion of its revenue from toll roads.²⁶⁷

Until recently, Missouri wasn't alone in its out-of-date fuel tax rate. Georgia had a similar problem - from 1993 to 2015, Georgia did not adjust its fuel tax for the rate of inflation; the state faced a billion dollar deficit for infrastructure maintenance and improvement.²⁶⁸ To address this shortfall, Georgia enacted legislation that updated its fuel tax to match the rate of inflation and account for modern vehicles' ever-increasing fuel economy.²⁶⁹ Since its enactment, Georgia's legislation has resulted in a large influx of much needed infrastructure revenue.²⁷⁰

²⁶¹ See MODOT Guide at 34.

²⁶² See McKenna Testimony.

²⁶³ See MODOT Guide at 3.

²⁶⁴ See MODOT Guide at 5.

²⁶⁵ See McKenna Testimony.

²⁶⁶ See, e.g., James Salzer, *Fuel Tax Hike Fueling Big Revenue Boost for Georgia*, The Atlanta Journal-Constitution (October 13, 2015), available at <http://www.ajc.com/news/state--regional-govt--politics/fuel-tax-hike-fueling-big-revenue-boost-for-georgia/mXtvrHJmK2MC4JAONZL8XK/>.

²⁶⁷ See McKenna Testimony.

²⁶⁸ See Georgia Transportation Alliance, *Summary of 2015 Transportation Legislation*, available at <http://www.gatransportation.org/wp-content/uploads/2015/09/GTA-Final-Summary-of-HB-1701.pdf>.

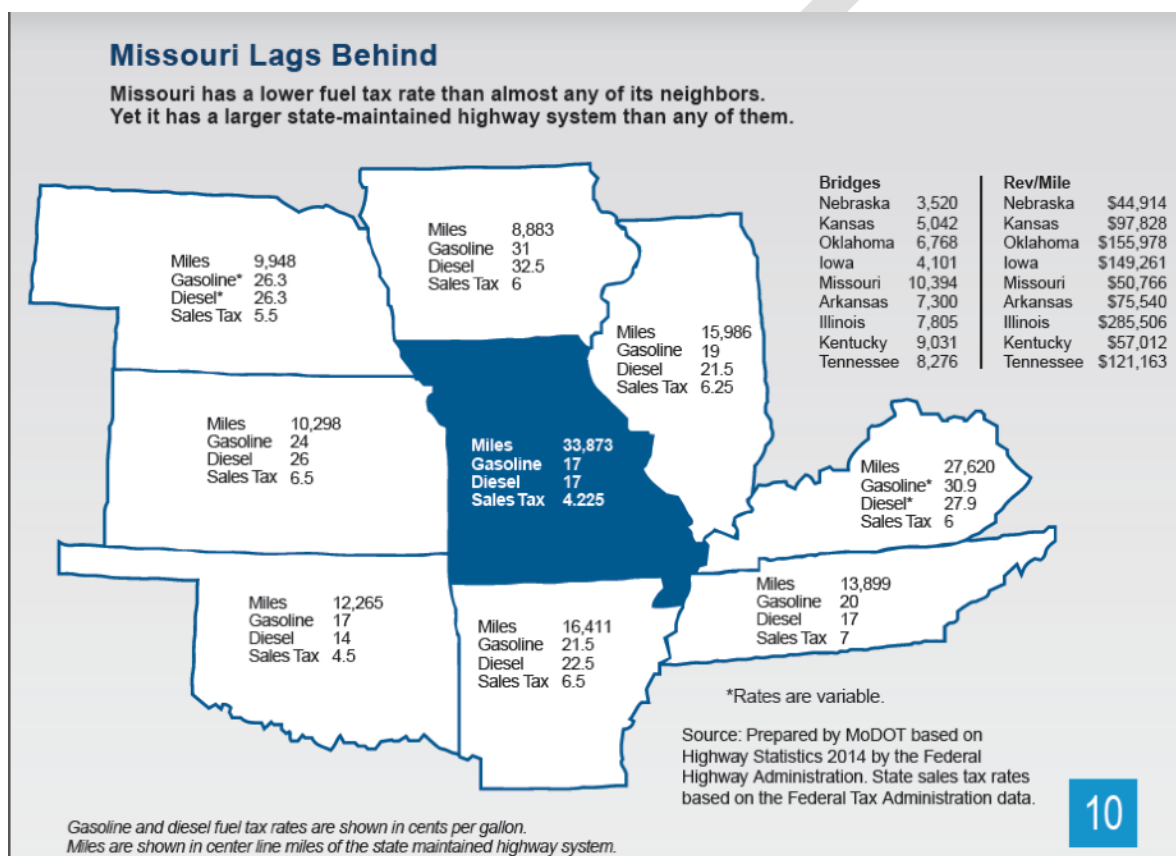
²⁶⁹ See McKenna Testimony.

²⁷⁰ See, e.g., James Salzer, *Georgia Ends Fiscal Year With a Revenue Boost of Nearly 10%*, The Atlanta Journal-Constitution (July 12, 2016), available at <http://www.myajc.com/news/state--regional-govt--politics/georgia-ends-fiscal-year-with-revenue-boost-nearly-percent/KWcizhRgNjgPStXaWgb8GK/>; James Salzer, *Fuel Tax Hike Fueling Big Revenue Boost for Georgia*, The Atlanta Journal-Constitution (October 13, 2015), available at <http://www.ajc.com/news/state--regional-govt--politics/fuel-tax-hike-fueling-big-revenue-boost-for-georgia/mXtvrHJmK2MC4JAONZL8XK/>.

Recommendation: Missouri should adjust its fuel tax to match the rate of inflation and account for increasing fuel economy, enabling the State to fund critical infrastructure maintenance and improvement.

- Missouri's current fuel tax is out of date with inflated maintenance and construction costs. To ensure that Missouri can become a best-in-class state to do business, the State must address its infrastructure funding shortfall.
- Following Georgia's successful model, Missouri's should tie its fuel tax rate to (1) consumer price index and (2) average fuel economy to ensure that the State is able to provide Missourians with high-quality roads and bridges for years to come.

Figure 1.X: Missouri's Transportation Funding Compared to its Border States²⁷¹



VIII. TAX CREDITS

A. Overview

Missouri's use of tax credits is extensive and expanding. At its core, a tax credit is simply a financial instrument that can be used to offset a tax liability. But in Missouri, tax credits have become the primary tool

²⁷¹ See MODOT Guide at 10.

chosen by the legislature to incent economic development and other types of public behavior. Since adopting the first tax credit program in 1973, the Senior Citizen's Property Tax Credit, the use of tax credits has expanded to several dozen programs accounting for over \$575 million in redemptions in FY 2016.²⁷² Missouri's ten largest tax credit programs by issuances are as follows:

TAX CREDIT TYPE	FY 2016 (\$)	TOTAL FY 2007 - FY 2016 (\$)
Low Income Housing	101,939,700.00	1,349,011,062.00
Missouri Quality Jobs	64,746,974.78	312,232,683.33
Historic Preservation	59,590,350.87	1,007,875,646.12
Missouri Works	23,741,677.22	27,477,384.78
Missouri Manufacturing Jobs	16,369,064.74	38,248,885.74
-Infrastructure Development	14,826,445.78	202,353,374.30
Neighborhood Assistance	13,761,480.00	109,839,962.00
Affordable Housing Assistance	13,171,092.00	72,269,177.00
Brownfield Remediation Tax	9,831,947.29	140,700,906.83
Missouri Works Retain Jobs	9,380,750.00	66,861,202.00
New Markets Tax Credit AKA Qualified Equity Investment	9,319,024.49	111,795,478.12
Business Use Incentives for Large Scale Development-BUILD	9,040,815.85	83,772,195.27

Initially, it should be noted that since Missouri's 2010 Tax Credit Review Commission Report, the level of tax credit redemption has largely remained the same. This should be cause for concern — the animating rationale for the creation of that Commission was Missouri's spectacular growth in tax credit usage.

Missouri's tax credits typically fall into three broadly defined categories: (1) those whose primary purpose and justification are to incent economic development, such as the Missouri Works Program; (2) those whose primary purpose are non-economic and mainly are used to support community development programs, such as the Neighborhood Assistance Program ("NAP"), Youth Opportunities Program ("YOP"), and Pregnancy Resource Center Program ("PRC", and collectively with NAP, YOP, and other similar programs, "Benevolent Tax Credits"); and (3) those programs that have combined economic development and social purpose goals, notably the Low Income Housing Tax Credit program ("LIHTC").

The Committee has received hundreds of public comments and heard from numerous witnesses at town hall style meetings across the state. From these interactions with the public, the Committee

²⁷² *Mo. Dep't of Economic Development Report*, Governor's Committee for Simple, Fair and Low Taxes (April 10, 2017 and April 24, 2017) [hereinafter Sallie Hemenway] (materials provided by Sallie Hemenway, of Mo. Dep't of Econ. Development).

acknowledges the great amount of good that Benevolent Tax Credits, are accomplishing throughout the State. The Committee heard several moving stories about non-profit recipients of Benevolent Tax Credits providing counseling to sex trafficking victims,²⁷³ caring for foster children,²⁷⁴ and providing critical care for newborn lives.²⁷⁵ In total, Benevolent Tax Credit programs make up less than 4% of total redeemed tax credits each year.²⁷⁶ Some of these programs are thinly spread—for example, the Domestic Violence Tax Credit's \$2 million allocation is spread evenly throughout the state, with some eligible centers receiving less than \$50,000. This modest allocation is made, despite the fact that these Benevolent Tax Credit programs have all the hallmarks of a successful tax credit program: (1) each tax credit recipient fulfill a public purpose; (2) many of these credits are competitively awarded; and (3) the amounts that are expended are modest compared to the programs' positive results. The Committee recommends that the General Assembly consider expanding several of the Benevolent Tax Credit programs, and specifically recommends that such expansions could be achieved by reducing tax credit programs whose efficiency and efficacy is less certain.

Upon inspection, the Committee concluded that several of the tax credit programs are not well designed. Many programs are structured as entitlements with little to no oversight. Indeed, several of Missouri's tax credit programs provide less than \$0.30 of economic benefit for each dollar of tax credit awarded. Broad, general reforms are necessary to ensure that Missouri's tax credit programs provide a positive return for the taxpayers' investment.

B. General Recommendations for All Tax Credits

As well articulated by an economic development expert, a well designed economic incentive program should embrace the following principles:

1. The incentive should facilitate an action that likely would not occur without the incentive;
2. State funding should be the lowest amount necessary to facilitate the action;
3. If the purpose is related to creating an economic benefit, the net state fiscal benefit of the project *must* be positive;
4. The incentive should be designed to provide maximum efficiency to the State;
5. The incentive should be fair and easy to access for eligible applicants;
6. The incentive should minimize complexity and the need for professional guidance;
7. The incentive should be properly tracked and should ensure accountability to the taxpayers;

²⁷³ *Public Comment*, Governor's Committee for Simple, Fair and Low Taxes Town Hall in Hannibal (May 22, 2017) [hereinafter Town Hall in Hannibal].

²⁷⁴ *Public Comment*, Governor's Committee for Simple, Fair and Low Taxes Town Hall in Cape Girardeau (June 2, 2017) [hereinafter Town Hall in Cape Girardeau].

²⁷⁵ *Public Comment*, Governor's Committee for Simple, Fair and Low Taxes Town Hall in Springfield (June 7, 2017) [hereinafter Town Hall in Springfield].

²⁷⁶ *Mo. Dep't of Economic Development Report*, Governor's Committee for Simple, Fair and Low Taxes (April 10, 2017 and April 24, 2017) [hereinafter Sallie Hemenway] (materials provided by Sallie Hemenway, of Mo. Dep't of Econ. Development).

8. The public purpose should be clearly defined for each incentive – with clear goals, objectives, and benefits to the State;
9. Separate programs for specific types of businesses should be disfavored; and
10. The incentive program should be flexible.²⁷⁷

These goals are thoughtful and should form the basis for any discussion regarding tax credit reform. In order to meet these goals, the Committee recommends instituting specific reforms applicable to all of Missouri's tax credit programs. The most notable recommendation is to subject all tax credits to discretionary approval by the Missouri Department of Economic Development ("DED"). Currently, several tax credit programs (most notably the Historic Preservation Tax Credit program) are not subject to any State discretion.²⁷⁸ This means that there is no assurance that a specific authorization of a tax credit application will actually meet the State's goals or constitute an efficient and effective use of State resources.

Thus, first and foremost, the Committee recommends that DED be granted the discretion to deny any tax credit application if it fails to meet any one of four simple tests:

1. **Recommendation: Allow Denial of any Tax Credit Application that Fails to Meet a Public Purpose**

All tax credits should meet a legislatively defined "public purpose" that is periodically reviewed and amended by the General Assembly. Some may point out that by the creation of a tax credit program itself, the legislature necessarily makes determination of a public purpose. While this may be true for purposes of a review of compliance with Article X, Section 35 of the Missouri Constitution,²⁷⁹ it is not persuasive as a practical matter. Broadly drafted tax credit programs allow agency level determinations to shift the implementation of a program away from the path that the General Assembly originally envisioned. Thus, the fact that a given authorization may survive a constitutional challenge does not shed light on whether or not it meets the public's current needs.

This can be counteracted through a general public purpose statute under which the General Assembly specifically enumerates acceptable and non-acceptable "public purposes" that tax credits must achieve. For instance, if desired, the legislature could state that the use of a tax credit "in furtherance of addressing urban blight" is acceptable, but could also specify that the use of tax credits to improve an existing four star luxury hotel is not.²⁸⁰ The precision adopted would be up to the desire of the legislature. A model statute listing possible public purpose designations is attached to this report as Appendix A.

²⁷⁷ Downing, May 2, 2014

²⁷⁸ *Mo. Dep't of Economic Development Report*, Governor's Committee for Simple, Fair and Low Taxes (April 10, 2017 and April 24, 2017) [hereinafter Sallie Hemenway] (materials provided by Sallie Hemenway, of Mo. Dep't of Econ. Development).

²⁷⁹ See *gen. Manzara v. State of Missouri*, 343 S.W.3d 656 (Mo. 2011) (en banc)(Wolfe concurring) (noting the broad grant of public purpose under the Missouri Constitution).

²⁸⁰ By way of example, Horsley and Vockrodt, *InterContinental, a premier KC hotel, seeks 'blight' designation*, Kansas City Star (September 2, 2016) (available at <http://www.kansascity.com/news/local/article99693672.html>).

In practice, this reform would mean that DED, or such other administering agency as the General Assembly sees fit, must certify the specific statutory public purpose that the issuance of the tax credit would further. If the administering agency were unable to do so, then the application would be denied.

2. Recommendation: Allow Denial of a Tax Credit Application if the Activity Would Occur Without State Incentives

State incentives should only be used to incent activity that would not otherwise occur.²⁸¹ The importance of this point is self-evident — if the market would naturally incentivize an activity to occur, there is no need for government intervention. At the Committee's public hearings and town hall meetings, many tax credit recipients told the Committee that the continued existence of their activities and programs would be jeopardized if certain tax credit programs were retired. But in practice, most of Missouri's tax credit programs do not require applicants to demonstrate that the proposed project would not occur without State incentives. Thus, the Committee is left with the uneasy conclusion that at least some tax credit recipients have no true need for tax credit rewards. A simple showing by an applicant that "but for" the award of tax credits, the applicant's project would not occur, would ensure that truly needy applicants are not elbowed out by applicants whose awards would essentially constitute a private windfall.

In practice, this reform would mean that DED, or such other administering agency as the General Assembly sees fit, would require an applicant to show a financing gap. This would require an applicant to show its financial condition, its efforts to secure funding from other sources, and a meaningful showing that it truly needs the requested tax credit. If the applicant were unable to do so, then the administering agency could deny the application.

3. Recommendation: For Economic Development Tax Credits, Allow Denial of Applications that Fail to Demonstrate a Positive Fiscal Return to the State

A final key recommendation for economic development-focused tax credit programs is the assurance that the expenditure of tax credits will leave the State's budget in a better position. The rationale for such a requirement, again, is self evident. If the tax credit program's goal is economic growth, a negative return to the state's fiscal bottom line suggests that the expenditure of public funds resulted in only private enrichment - that is, the tax credit recipient's personal profit exceeded the return to Missouri's taxpayers. This is not a proper public purpose.²⁸² For economic development to be within the public good, Missouri's taxpayers should receive a net economic benefit.

This is a workable requirement for all economic development tax credits. First, DED already models the fiscal return for several tax credit programs, including the Brownfield Remediation tax credit. Although some members of the Committee have reservations about the efficacy of DED's modeling, their concerns are that the current modeling *overstates* the fiscal impact. But most state lawmakers agree that if DED cannot find a model that indicates a positive return to the State budget, then there is little to no chance that a project will provide a net economic benefit to the taxpayers.

This recommendation would not impose a major burden for applicants. During the Committee's hearings and town halls, nearly all of the economic and redevelopment tax credit recipients who spoke assured the Committee that the issuances of tax credits for their various uses resulted in significant

²⁸¹ Downing, May 2, 2014

²⁸² See *Curchin v. Missouri Ind. Development Bd.*, 722 S.W.2d930, 933 (Mo. banc 1987).

multipliers of indirect economic activity.²⁸³ While the Committee questions the accuracy of multipliers and estimates of indirect economic benefit (see Historic Preservation Tax Credit section below), tax credit users could certainly have a chance to make such a showing to DED. DED Acting Director Mike Downing recommended that DED could approve a greater percentage of high-quality tax credit applications by requiring applicants to show that their projects would provide a 2-to-1 benefit to the State. The Committee believes that this is a sound approach and recommends its adoption.

4. Recommendation: Allow DED to Deny Applications for Failure to Show Technical or Financial Ability to Perform

It would be improper to award tax credits to any entity that cannot prove its ability to bring its proposed project to completion. Unfortunately, this safeguard doesn't exist for several key tax credit programs.²⁸⁴ A modest proposal would be to allow DED to deny awards to applicants who are unable to amply demonstrate a technical and financial ability to perform their proposed project.

Additionally, the Committee recommends two new policies to ensure that Missourians are protected from wasteful or unscrupulous use of tax credits:

Recommendation: Annually Appropriate the Amount of Tax Credits for Each Program and Allow for Gubernatorial Withholding

The Committee found that many of the concerns related to tax credits center on the sheer amount that are authorized, issued, and redeemed each year. Past Tax Credit Review Commissions and reports have noted that several tax credit programs' unrestrained growth without annual oversight from the General Assembly have been significant contributors to Missouri's state of massive annual tax credit liabilities.²⁸⁵ The Missouri Tax Credit Review Commission's 2010 Report concluded that annual appropriations for tax credits would be unworkable.²⁸⁶ But in the past seven years since that Commission's report, it appears clear that their conclusion was not correct — annual appropriations for new authorizations of tax credits have been empirically proven to work.

In 2014, the General Assembly passed SB 729, which subjected the Wood Energy Tax Credit to a statutory cap of \$6 million and a command that "[t]here shall be no tax credits authorized under sections 135.300 to 135.311 unless an appropriation is made for such tax credits."²⁸⁷ In practice, this means that the General Assembly, through the normal budget process, sets the total amount of Wood Energy Tax Credits that may be authorized in a given year. The success of this approach is clear, as the Wood Energy Tax Credit has not experienced breakneck growth in authorizations or issuances since the adoption of annual appropriations. DED has been able to effectively manage this program with its annual appropriation requirement, and there is no reason to believe that funding via appropriations would not work for other programs.

²⁸³ Cite Townhall/ Missouri Growth Study.

²⁸⁴ Cite Mamtek incident.

²⁸⁵ 2010 COMMISSION REPORT, *supra* note 157, at 12.

²⁸⁶ 2010 COMMISSION REPORT, *supra* note 157, at 12.

²⁸⁷ Mo. Rev. Stat. § 135.305.

In addition, the Committee recommends that the Governor be expressly given the right to withhold issuances of new tax credits in the event of a fiscal emergency. Under Article IV, Section 27 of the Missouri Constitution, the Governor is charged with stabilizing the budget through his ability to withhold line item expenditures. But under current law, it appears that the Governor may not have a ready path to exercise the same powers in regards to the issuance of new tax credits, even if it is readily apparent that fiscal disaster is on the horizon. This should be remedied. As such, the Governor should be granted the authority to restrain tax credit issuances to prevent future budget shortfalls.

Recommendation: Enact a General False Claims Act to Reign in Fraud, Waste, and Abuse

In its 2010 report, the Tax Credit Review Commission identified issues of non-compliance with tax credit program requirements as a significant matter of concern to be addressed by the General Assembly. In response to these concerns, the Tax Credit Review Commission recommended the creation of “strict statutory clawbacks to be enforced by the state. . .” A “clawback” is a statutory or contractual provision that enables the administering agency to recapture a tax credit already issued or to require repayment of the tax credit’s face value in the event of failure to perform or other default. For transferable tax credits, clawback provisions typically provide a remedy against the initial recipient of the credit rather than a subsequent purchaser.

Since the Tax Credit Review Commission’s 2010 report, it has become apparent that the risk of non-compliance can often be one of outright fraud. One of Missouri’s most visible examples was the failure of the Mamtek sucralose facility in Moberly.²⁸⁸ While the tax credits authorized in that project were never issued due to the configuration of the Missouri Works Program,²⁸⁹ the Committee is concerned that most of the State’s tax credit programs lack adequate safeguards to prevent fraud. With the sheer volume of tax credits issued each year in Missouri, taxpayers deserve protection from unscrupulous tax credit recipients’ fraud, waste, and abuse.

Upon the Committee’s review, few of the tax credit programs’ current protections go far enough to ensure taxpayers’ protection. Contractual clawbacks are often ineffective; many applicants subject to clawback penalties are functionally bankrupt by the time that DED refers the case to the Attorney General’s Office. A contractual right that can’t realistically protect the taxpayers is of little use.

As such, the Committee recommends the adoption of a robust general false claims act that would apply to any issuances of tax credits. The Committee believes that such an act should be exclusively administered, overseen, and instituted by the Missouri Attorney General’s Office. Along with treble damages for fraud, the general false claims act should include broad injunctive provisions, investigative powers, and criminal penalties for applicants who abuse the system. Such an act would provide assurances to the taxpayers that, should tax credits be misappropriated by unscrupulous recipients, their hard earned tax dollars would not be lost. A proposed act is attached to this report.

C. Tax Credit Stability Fund

²⁸⁸ See Susan Berfield, *A Missouri Town’s Sweet Dreams Turn Sour*, Bloomberg Business Week (January 5, 2012) (<https://www.bloomberg.com/news/articles/2012-01-05/a-missouri-towns-sweet-dreams-turn-sour>)

²⁸⁹ As discussed in the section on Missouri Works, benefits are only awarded if the promised jobs from the economic development proposal actually come to fruition.

Under Missouri's current tax credit system, most programs' expenses are "off-book." Despite the fact that tax credits have a very real effect on the overall state budget, that vast majority of tax credits are not handled through the normal appropriations process within the General Assembly. As one member of the Committee commented at a public hearing, most important legislative priorities must endure the budgetary process of the state, including care for the elderly and disabled. There is no good reason that tax credits should not be subject to the same discernment. In addition to the lack of legislative allocation, the General Assembly does not readily track the total amount of tax credits that are authorized pursuant to the various tax credit programs. Moreover, statutory caps on tax credits are valuable tools to rein in the extreme excesses of tax credit programs. For example, the General Assembly may wish to restrict the volume of tax credits authorized during lean years of State revenue. However, Missouri's current tax credit system is not set up to do this.

Recommendation: The General Assembly should create a Tax Credit Stability Fund ("TCSF") funded from a Gross Receipts Tax (discussed above) to pre-pay for new tax credit authorizations.

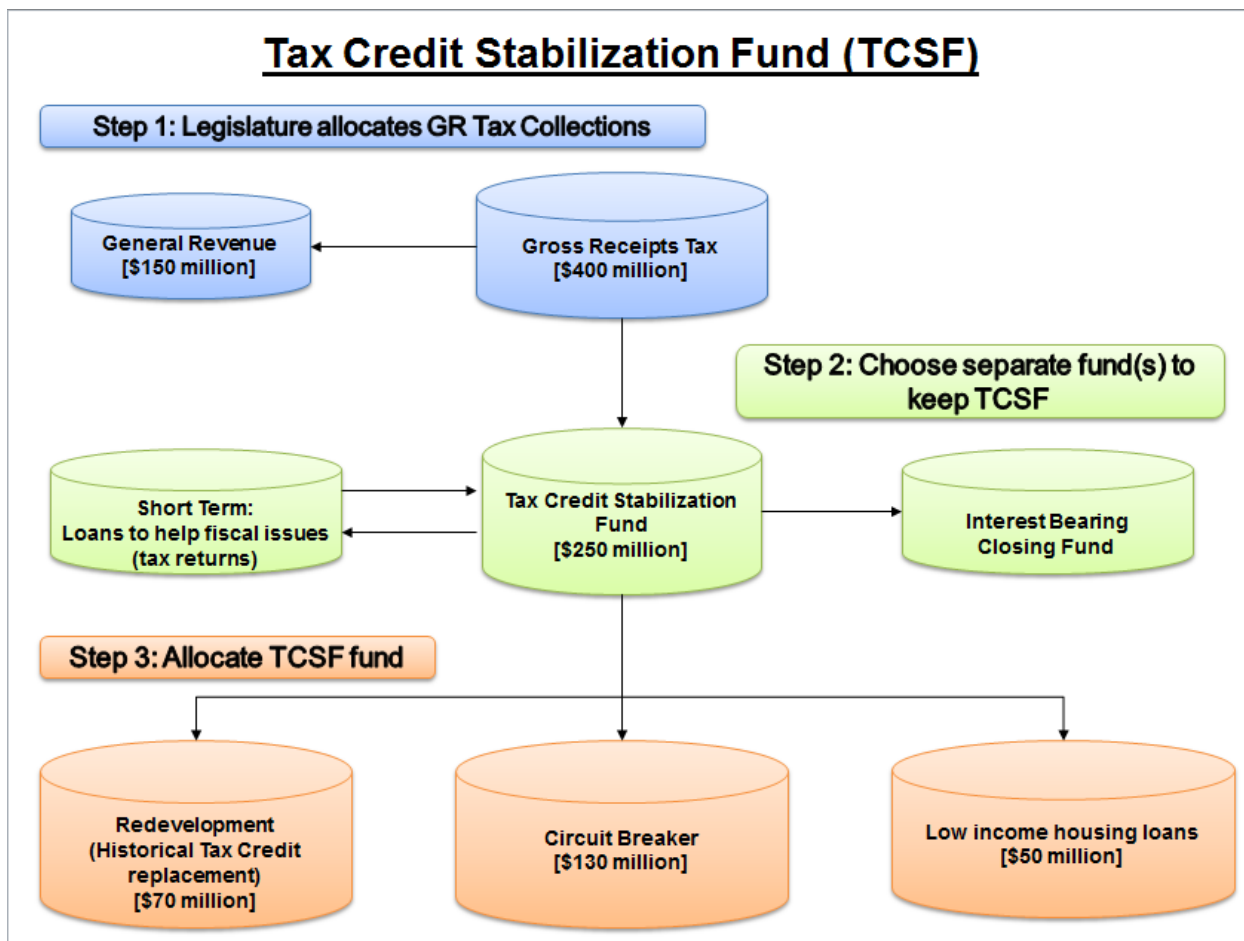
In practice the TCSF would act as a "supercap" over all tax credit programs to ensure that the General Assembly regulates the State's volume of overall tax credit usage. In addition, the TCSF would prevent the state from issuing tax credits without a defined plan on how to pay for them. Figure 2.1 below set forth a diagram for a potential TCSF.

In Step 1, the Missouri Department of Revenue would estimate the collections of gross receipts tax for the year. This estimate would form the basis for the TCSF's maximum funding for the upcoming Fiscal Year. Figure 2.1 estimates that the gross receipts tax would generate \$400 million for the year. Through the normal appropriations process, the General Assembly would decide what percentage of the gross receipts tax revenue would be placed in the TCSF — the remainder would be placed in the State's general revenue. In Figure 2.1, the General Assembly would place \$250 million in the TCSF and the remaining \$150 million in general revenue. The appropriated TCSF amount would set the TCSF cap for virtually every Missouri tax credit program.

In Step 2, the TCSF funds would be placed in a separate fund dedicated for the redemption of tax credits. This fund could serve two needs for the state. First, the fund could be placed in an interest-bearing account, with the interest used to augment the discretionary closing fund (discussed below). Second, the fund could also provide the State with short-term loans in order to stabilize revenue spikes — a key public policy challenge.

In Step 3, the Governor would recommend funding levels for each program subject to the TCSF. The Governor could not recommend an amount in the aggregate that would exceed the total cap set decided by the General Assembly. The General Assembly would then decide whether to accept these proposed individual program caps.

Figure 2.1



D. Low Income Housing Tax Credits

Missouri's Low Income Housing Tax Credit ("LIHTC") program provides incentives for the construction and maintenance of affordable rental housing throughout the State.²⁹⁰ Under Missouri's LIHTC program, the Missouri Housing Development Commission ("MHDC") is authorized to issue a state tax credit equal to 9% of a development's eligible costs to qualified owners of affordable rental housing developments, capped at the total amount of federal LIHTCs awarded to such development.²⁹¹ MHDC has discretion to select the most competitive developments and allocate state LIHTCs accordingly.²⁹² Missouri also offers a

²⁹⁰ See MO. HOUSING DEVELOPMENT COMM., MHDC LOW INCOME HOUSING TAX CREDIT PROGRAM SUMMARY [hereinafter MHDC LIHTC PROGRAM SUMMARY] (prepared upon letter request from Governor's Committee on Simple, Fair and Low Taxes).

²⁹¹ See MO. HOUSING DEVELOPMENT COMM., MHDC LOW INCOME HOUSING TAX CREDIT PROGRAM SUMMARY [hereinafter MHDC LIHTC PROGRAM SUMMARY] (prepared upon letter request from Governor's Committee on Simple, Fair and Low Taxes).

²⁹² See MO. HOUSING DEVELOPMENT COMM., MHDC LOW INCOME HOUSING TAX CREDIT PROGRAM SUMMARY [hereinafter MHDC LIHTC PROGRAM SUMMARY] (prepared upon letter request from Governor's Committee on Simple, Fair and Low Taxes).

LIHTC equal to 4% of a development's eligible costs for developments financed with tax-exempt bonds, capped at \$6 million per year for a period of 10 years (i.e. \$60 million).²⁹³

The state LIHTC program was created to supplement the federal LIHTC program, which annually allocates a set amount of federal LIHTCs based on the State's population each year.²⁹⁴ MHDC may grant state LIHTCs up to the amount of federal LIHTCs allocated to Missouri in a given year, set annually by the U.S. Internal Revenue Service.²⁹⁵ In FY 2016, MHDC authorized over \$167 million of state LIHTCs in addition to a matching amount of federal LIHTCs, resulting in over \$300 million of state and federal LIHTCs committed to affordable housing developments within Missouri.²⁹⁶

To be eligible for the state LIHTC, a recipient must:

- (1) Own at least part of the proposed affordable housing development;
- (2) Develop rental housing that:
 - (A) Rents at least 20% of its units to families earning 50% of the area median income, or
 - (B) Rents at least 40% of its units to families earning 60% of the area median income;
- (3) Maintain the affordability of the rental units by restricting rents for an extended period of time, typically 30 years;
- (4) Assist in the production of financially viable, market-appropriate housing in areas of greatest housing need in the State; and
- (5) Be sponsored by an entity with prior successful housing experience and the ability to proceed in an expeditious manner.²⁹⁷

LIHTCs are issued annually in equal increments over a period of 10 years and may be carried back up to 3 tax years or carried forward up to 5 tax years.²⁹⁸ LIHTCs may be transferred among owners within a development's ownership structure, but not to persons outside the ownership group.²⁹⁹ Developers who receive LIHTCs typically team with investors to share ownership of the development. These ownership groups are often formed by third-party syndicators, who receive a portion of the LIHTC proceeds for their efforts.³⁰⁰

²⁹³ See MHDC Low Income Housing Tax Credit Program Summary, received pursuant to the Committee's letter request (the "MHDC LIHTC Program Summary").

²⁹⁴ See Missouri State Audit of the Low Income Housing Tax Credit Program (March 2014) at 4 (the "2014 LIHTC Audit").

²⁹⁵ See MHDC LIHTC Program Summary.

²⁹⁶ See *Report on Missouri Tax Credits Administered by the Department of Economic Development* (February 2017) at 12 (the "2017 DED Tax Credit Report").

²⁹⁷ See MHDC LIHTC PROGRAM SUMMARY, *supra* note ____.

²⁹⁸ See RSMo. § 135.352.4.

²⁹⁹ See MHDC LIHTC PROGRAM SUMMARY, *supra* note ____.

³⁰⁰ See 2014 LIHTC Audit at 6.

There are nearly 100,000 active affordable housing units in Missouri, and roughly 60% of them were built using state LIHTCs.³⁰¹ Over the course of four town hall meetings, many Missourians described a significant need for affordable housing throughout the State. Phyllis Woehr,³⁰² a tenant in a Maryville LIHTC development, explained to the Committee that accessible affordable housing had enabled her to live independently after being confined to a wheelchair.³⁰³ Accessible, affordable independent living developments provide an alternative to costly nursing homes and enable residents to live with dignity. Affordable housing is also a critical piece of workforce development. Jonas Arjes, Executive Director of the Taney County Partnership, conveyed Branson's dire need for affordable housing to accommodate workers.³⁰⁴ According to Mr. Arjes, Branson has approximately 1,000 vacant jobs that remain empty due to a dearth of affordable housing for would-be workers.³⁰⁵ Missouri's LIHTC program has played a role in many affordable housing developments throughout the State, and a number of Missourians implored the Committee to recommend continuing and strengthening the program.³⁰⁶

Though Missouri's LIHTC program has assisted with numerous affordable housing developments across the State, it is widely criticized as an inefficient use of public funds.³⁰⁷ Though Missouri authorizes as many tax credits as the federal LIHTC program, experts estimate that the state LIHTC program has led to the construction of just one third more affordable housing units than would have been constructed under the federal program alone.³⁰⁸ In short, Missouri's LIHTC program costs as much as the federal LIHTC program, but delivers only one third of the results.

As of 2014, Missouri realized only \$0.42 of affordable housing for each dollar of state LIHTC awarded.³⁰⁹ And over the last 15 fiscal years, Missourians have received only \$0.15 of economic benefit for each dollar of state LIHTC awarded.³¹⁰ In other words, over the past ten fiscal years, Missouri has authorized over \$1.6 billion of state LIHTC and received less than \$245 million in return, for a loss of over \$1.3 billion.³¹¹ As of 2013, Missouri's LIHTC program financed affordable housing construction at an interest

³⁰¹ Testimony of Stifel, Nicolaus & Company at the Committee's public hearing (June 12, 2017) (the "Stifel Presentation").

³⁰² NOTE TO DRAFT: Confirm spelling with roll from Town Hall.

³⁰³ Testimony of Phyllis Woehr (sp?) at the Committee's Town Hall in Maryville (May 17, 2017).

³⁰⁴ Testimony of Jonas Arjes at the Committee's Town Hall in Springfield (June 7, 2017).

³⁰⁵ Testimony of Jonas Arjes at the Committee's Town Hall in Springfield (June 7, 2017).

³⁰⁶ Testimony of Phyllis Woehr (sp?) at the Committee's Town Hall in Maryville (May 17, 2017).

³⁰⁷ See, e.g., Virginia Young, *Is Missouri's Costly Housing Tax Credit Untouchable Because of Industry's Clout?*, St. Louis Post-Dispatch (March 3, 2014); Christine Harbin, *Low Income Housing Tax Credit Mathematics*, Show-Me Institute (July 22, 2010), available at <http://showmeinstitute.org/blog/transparency/low-income-housing-tax-credit-mathematics>.

³⁰⁸ See Stifel Presentation.

³⁰⁹ See 2014 LIHTC Audit at 11.

³¹⁰ See 2017 DED Tax Credit Report at 13.

³¹¹ See DED 10 Year Tax Credit Report, received pursuant to the Committee's letter request.

rate to the State of over 19%, an extremely high rate considering that Missouri holds a AAA bond rating.³¹² A Missouri Tax Credit Review Commission report rightly concludes that this anomaly “should be a source of great embarrassment to Missouri.”³¹³

Despite its low efficiency, Missouri’s LIHTC program has become the State’s largest tax credit program. For FY 2017, Missouri is on a pace to authorize \$205 million LIHTCs.³¹⁴ For comparison, the State’s Youth Opportunities Tax Credit Program and Neighborhood Assistance Tax Credit Program, which provide much-needed resources, mentoring, and activities to Missouri’s neediest young people, are capped at \$6 million and \$16 million, respectively.³¹⁵ From FY 1997 to 2013, Missouri exceeded its projections for authorized LIHTCs by \$842 million.³¹⁶ And as of FY 2016, there is \$827,860,826 of state LIHTCs outstanding, casting an ominous shadow over future state budgets.³¹⁷

The state LIHTC’s loss of value is largely due to the credit’s federal tax consequences. The state LIHTC reduces the amount of state taxes payable, which reduces the federal tax deduction for state taxes paid.³¹⁸ The credit’s additional loss of value is funneled to syndicators and investors.³¹⁹ And in many cases, developers redeem state LIHTCs simultaneously with another type of state tax credit for the same expense - this practice of “stacking” produces no economic benefit to the State. Despite the State’s massive investment in its LIHTC program, Missourians receive a disproportionately small amount of affordable housing in return.

Missouri has one of the two largest state LIHTC programs in the country.³²⁰ As of 2014, Missouri spent \$28.60 per person on its LIHTC program.³²¹ The next highest-spending state spent just over \$20.00 per person on its LIHTC program, and most other states spent far less.³²² While Missouri and Georgia link their state LIHTC caps to the federal LIHTC allocations they receive each year, most states with their own

³¹² See *Missouri’s Top-Grade AAA Credit Rating is Reaffirmed*, Kansas City Star (April 28, 2016), available at <http://www.kansascity.com/news/business/article74468407.html>; see also 2014 LIHTC Audit at 13-14.

³¹³ See Supplemental (and Minority) Report by Certain Members of the Missouri Tax Credit Review Commission (December 12, 2012) at 8.

³¹⁴ See 2017 DED Tax Credit Report at 12.

³¹⁵ See DED Youth Opportunities Tax Credit Program Summary, available at <https://ded.mo.gov/sites/default/files/programs/flyers/YOPProgramSummary13.pdf>; DED Neighborhood Assistance Program Tax Credit Program Summary, available at <https://ded.mo.gov/sites/default/files/programs/flyers/NAPProgramSummary2016.pdf>

³¹⁶ See 2014 LIHTC Audit at 12-13.

³¹⁷ See materials provided by Sallie Hemenway of DED at Committee’s public hearing (April 24, 2017).

³¹⁸ Testimony of Mark Gardner at the Committee’s public hearing (June 5, 2017); 2014 LIHTC Audit at 13.

³¹⁹ See 2014 LIHTC Audit at 11.

³²⁰ See 2014 LIHTC AUDIT, *supra* note ___, at 2

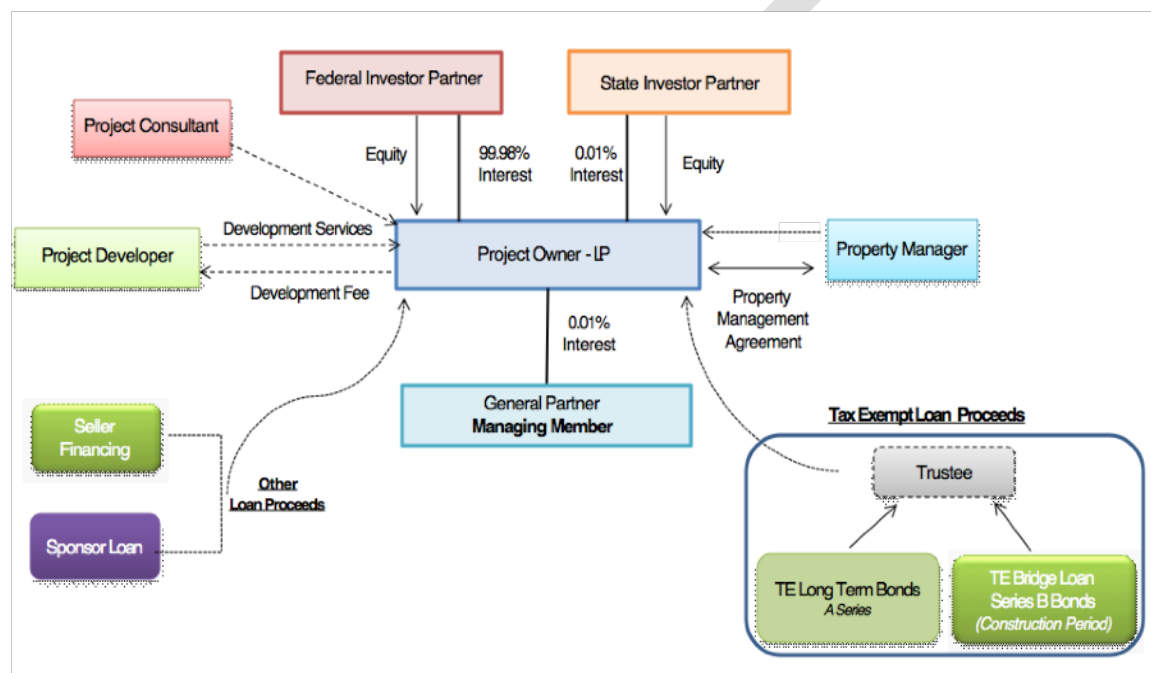
³²¹ See 2014 LIHTC Audit at 11

³²² See 2014 LIHTC Audit at 11

LIHTC programs institute a much lower cap.³²³ For example, Massachusetts caps its program at \$20 million per year (but will drop to \$10 million in 2019), Colorado caps its state LIHTC program at \$5 million per year, and Oklahoma caps its program at \$4 million per year.³²⁴

Despite the state LIHTC program's size and inefficiency, it may be possible to deliver affordable housing for a much lower price. Stifel, Nicolaus & Company ("Stifel") illustrated the state LIHTC program's investor model under existing law (see Figure 2.2 below), noting the great lengths investors and developers employ in order to comply with Missouri law. However, Stifel introduced the Committee to a state LIHTC model that would reduce complexity, increase the state credits' value, and introduce added budget stability to the State's general revenue (see Figure 2.3 below).

Figure 2.2: Typical LIHTC Project Organizational Chart (under current Missouri statutes)³²⁵



First, Stifel suggested that certificating state LIHTCs could immediately increase their value. LIHTC certificates would provide investors with a transferable credit that wouldn't require ownership of the affordable housing project, thus reducing the need for the complex ownership structure shown in Figure 2.2. This simplicity and transferability would provide more favorable federal tax treatment, lower investors' costs, and ultimately make the state LIHTC more valuable. To ensure that the State realizes the best price for certificated LIHTCs, MHDC could auction them off to the highest bidders.

Second, the certificated LIHTC proceeds could be used to issue direct loans to affordable housing developments. This would eliminate the need for costly, inefficient third-party syndication, resulting in more

³²³ See 2014 LIHTC AUDIT, *supra* note ___, at 12

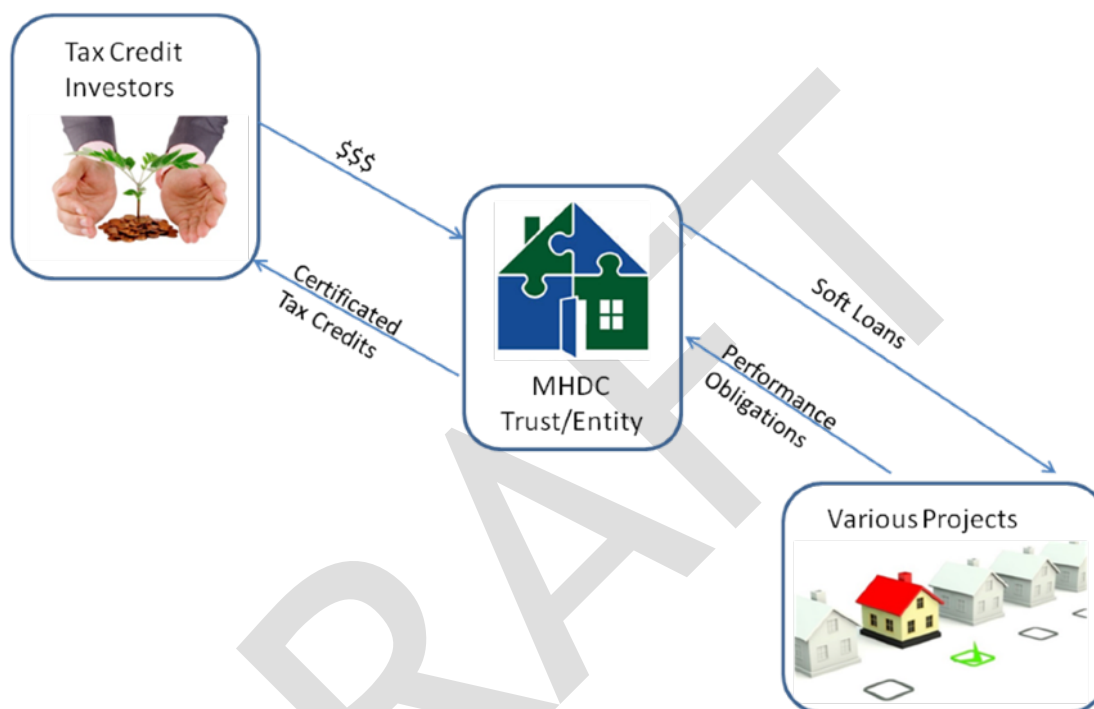
³²⁴ See Novogradac & Company LLP, *State LIHTC Program Descriptions*, available at <https://www.novoco.com/resource-centers/affordable-housing-tax-credits/application-allocation/state-lihtc-program-descriptions>.

³²⁵ See Stifel Presentation.

dollars going toward affordable housing - Missouri could get more affordable housing for the same amount of tax credits. The loans would be subject to the same recapture protections provided by Missouri's current LIHTC - if a development failed to meet compliance guidelines, the loan would not be forgiven.

Third, the State could reduce its current LIHTC obligations by repurchasing outstanding LIHTC in return for the new, more valuable certificated LIHTC. This immediate approach would allow the State to reduce its outstanding LIHTC liabilities by 15-20% for all tax credits repurchased.

Figure 2.3 - Alternative LIHTC Project Financing Chart³²⁶



Missourians have a sincere need for high-quality affordable housing, but Missouri's LIHTC program produces disproportionately low affordable housing units compared to taxpayers' massive investment. The following recommendations would help simplify the existing LIHTC program and provide quality affordable housing at a fairer, lower price for Missourians.

Recommendation: Convert the state LIHTC program to a low- or no-interest loan program (the "LIH Loan Program") for affordable housing construction, as demonstrated in Figure 2.3 above.

- Switching to the LIH Loan Program would eliminate most of the inefficiencies of the current tax credit program, including federal tax consequences and third-party syndication fees. 100% of State LIH Loans would go toward housing construction, a vast improvement from the current LIHTC's 42% efficacy.
- MHDC has an AA+ bond rating and could effectively transition from issuing LIHTCs to LIH Loans.

³²⁶ See Stifel Presentation.

Recommendation: Repurchase outstanding LIHTCs through MHDC and exchange them for certificated credits with shorter redemption periods, saving the State 15-20% of its outstanding LIHTC liabilities in the process.³²⁷

- Under a certificated tax credit model, MHDC would issue certificates that investors could purchase to reduce their Missouri tax liability. Unlike the current state LIHTCs, certificated tax credits could be transferred to persons outside of the ownership group, expanding the pool of potential investors.³²⁸ This would increase the credits' marketability.
- According to Stifel, for every dollar of outstanding LIHTCs repurchased, the State would save approximately 15-20% of its associated liability.³²⁹

Recommendation: Subject the LIH Loan Program to the overall Tax Credit Stability Fund authorization cap (discussed above).

- The Tax Credit Stability Fund would place a cap on the overall amount of LIH Loans issued in a given year, and the LIH Loan Program would be subject to appropriation for the General Assembly to adjust the program's budget allocation as needed.
 - Affordable housing is important, but in a world of limited resources, the LIH Loan Program must be evaluated along with other critical budget needs like schools and mental health funding.

E. Historic Preservation Tax Credits

Missouri's Historic Preservation Tax Credit ("HPTC") program provides incentives for the redevelopment of commercial and residential historic structures within the State.³³⁰ Under Missouri's HPTC program, DED is authorized to provide a tax credit for 25% of the eligible costs and expenses for the rehabilitation of approved historic structures.³³¹ The State may grant up to \$140 million of HPTC per fiscal year; however, projects receiving under \$275,000 of HPTC do not count toward the \$140 million cap.³³² Missouri's HPTC program also provides tax credits of up to \$250,000 per project to rehabilitate owner-occupied residences.³³³

³²⁷ See Stifel Presentation.

³²⁸ See 2014 LIHTC Audit at 14.

³²⁹ See Stifel Presentation.

³³⁰ See Missouri Department of Economic Development Historic Preservation Tax Credit Program Summary, available at https://ded.mo.gov/sites/default/files/programs/flyers/HistPres_ProgSummary_2016_0.pdf (the "HPTC Program Summary").

³³¹ See Missouri Department of Economic Development Historic Preservation Tax Credit Program Summary, available at https://ded.mo.gov/sites/default/files/programs/flyers/HistPres_ProgSummary_2016_0.pdf (the "HPTC Program Summary").

³³² See RSMo. § 253.550.2.

³³³ See RSMo. § 253.550.3.

Applicants are entitled to the HPTC if they meet the following requirements:

- (1) The property to be rehabilitated is:
 - (A) listed on the National Register of Historic Places;
 - (B) certified by the Missouri Department of Natural Resources (“DNR”) as contributing to the historical significance of a certified historic district listed on the National Register; or
 - (C) located within a local historic district that has been certified by the United States Department of the Interior;
- (2) The applicant is a for-profit entity (i.e. the applicant cannot be a not-for profit or governmental entity); and
- (3) The costs and expenses associated with the rehabilitation must exceed 50% of the property’s total basis (i.e. the cost to acquire the property).³³⁴

HPTCs must be applied to the recipient’s taxes in the year in which they are issued. If the HPTCs cannot be applied in the year they were issued, they may be carried back up to 3 tax years or carried forward up to 10 tax years.³³⁵

Missouri’s HPTC program is the State’s second-largest tax credit program, accounting for over \$1.2 billion in authorized tax credits, over \$1 billion of issued tax credits, and over \$1 billion of redeemed tax credits from FY 2007 through 2016.³³⁶ Additionally, the United State National Park Service provides a federal HPTC that entitles recipients to a tax credit equal to 20% of a project’s qualified rehabilitation expenses. In FY 2016, Missouri historic rehabilitation projects were authorized to receive over \$600 million of federal HPTC and over \$90 million of Missouri HPTC.³³⁷ According to St. Louis developer Steven Stogel, since the state HPTC program’s creation in 1998, Missouri has incurred more qualified rehabilitation expenses than any other state, and St. Louis has incurred more qualified rehabilitation expenses than any other city in the country.³³⁸

Missouri has far and away the largest state HPTC program in the country.³³⁹ In a 2014 audit of Missouri’s HPTC program, the Missouri Auditor noted that Missouri could lower its cap on HPTC

³³⁴ See HPTC Program Summary.

³³⁵ See RSMo. § 253.557.1.

³³⁶ See DED 10 Year Tax Credit Report, received pursuant to the Committee’s letter request.

³³⁷ See U.S. National Park Service, *Federal Tax Incentives for Rehabilitating Historic Buildings: Statistical Report and Analysis for Fiscal Year 2016*, available at <https://www.nps.gov/tps/tax-incentives/taxdocs/tax-incentives-2016statistical.pdf>; see also materials provided by Sallie Hemenway of DED at the Committee’s public hearings (April 10, 2017 and April 24, 2017).

³³⁸ Testimony of Steven Stogel at the Committee’s public hearing (June 5, 2017).

³³⁹ See Missouri State Audit of the Historic Preservation Tax Credit Program (March 2014) at 8-9, available at <https://app.auditor.mo.gov/repository/press/2014018832873.pdf> (the “2014 HPTC Audit”).

authorizations from \$140 million per year to \$75 million per year and still have one of the largest HPTC programs of any state.³⁴⁰

At the Committee's town hall meetings across the State, a number of Missourians spoke in favor of the state HPTC program. Developers in Hannibal, Cape Girardeau, and other Missouri cities have used HPTC to redevelop historic downtown areas and attract businesses and residents to long-vacant urban cores. Many Missourians claim that the HPTC is a powerful tool to recover blighted areas and spark economic growth. However, the HPTC program was not designed to combat blight or generate economic development. Missouri's program contains no statutory safeguards to incentivize these goals.

Developer Steve Smith from St. Louis cited examples of HPTC's success by incentivizing an initial property in a downtrodden district, which attracted private follow-on investment in surrounding buildings.³⁴¹ Mr. Smith described his first experience with the state HPTC, which enabled him to develop the Moto Museum in midtown St. Louis. According to Mr. Smith, after his HPTC-supported redevelopment, private investors redeveloped surrounding buildings without the use of State incentives, resulting in 55 new jobs.³⁴² Similarly, St. Louis's Cortex district launched with assistance from state HPTCs and has grown into a thriving tech and innovation center.

From the collective comments submitted to the Committee, it is evident that the state HPTC can be a helpful incentive to establish an initial anchor redevelopment in an underutilized area. Once one such attractive property exists, private investors are more likely to redevelop the surrounding area. However, Mr. Smith's example may be an exception rather than the norm. All eligible properties are statutorily entitled to the state HPTC, and subsequent redevelopments have no need to rely fully on private investment. A subsequent redevelopment in the same area may receive the state HPTC even if its value has already risen enough to incentivize private investment.

Economic development organizations from Excelsior Springs and Hannibal expressed concern that a large majority of state HPTCs are awarded to large projects in Kansas City and St. Louis, leaving few available credits for smaller communities. Additionally, school district officials working hard to make ends meet in Lewis County, Hannibal, and Belleview emphasized that, for a small fraction of the state HPTC awarded each year, their districts could provide much-needed resources to educate students, pay faculty and staff, and make critical improvements to long-neglected school buildings. These school officials acknowledged the importance of HPTCs to support Missouri's past, but they emphasized that the State could realize much greater returns by investing in Missouri's future.

The public testimony was compelling, but the numbers paint a stark picture. As calculated by DED, Missourians realized only \$0.26 of direct economic benefit from each dollar of state HPTC awarded from

³⁴⁰ See 2014 HPTC Audit at 8-9.

³⁴¹ Testimony of Steven Smith at the Committee's Town Hall in Cape Girardeau (June 2, 2017).

³⁴² Testimony of Steven Smith at the Committee's Town Hall in Cape Girardeau (June 2, 2017).

FY 2005 through FY 2016.³⁴³ In FY 2016, Missourians realized only \$0.16 of direct economic benefit for each dollar of state HPTC awarded.³⁴⁴

Several developers who benefit from the state HPTC claim that the program provides an enormous amount of indirect economic benefit to the State, up to billions of dollars of new economic output.³⁴⁵ However, several studies suggest that these estimates do not reflect reality.³⁴⁶ DED calculates HPTCs' indirect economic benefits (e.g. jobs created) based on information provided by HPTC recipients.³⁴⁷ But as evidenced in the 2014 HPTC Audit, DED simply does not have the capacity to verify or review the accuracy of reported jobs created - it is difficult to discern whether HPTC recipients report only new, permanent jobs or include jobs that existed prior to a building's rehabilitation.³⁴⁸

Furthermore, it is impossible to discern how much indirect economic benefit, if any, can be attributed to state HPTCs. Determining a tax credit's actual costs and benefits is extremely difficult, primarily because it is impossible to know how much economic activity would have occurred in the absence of the tax credit.³⁴⁹ State HPTC recipients are already eligible to receive the federal HPTC, which provides a credit of 20% of qualified rehabilitation expenses per project. Additionally, developers often use tax credits from multiple State programs on the same project, a practice known as "stacking". A developer from Kansas City suggests that stacking is "a necessary evil" despite the State's lower return on each stacked tax credit. But as the 2014 HPTC Audit points out, stacking tax credits results in additional profits for developers with no additional benefit to Missouri taxpayers.³⁵⁰

Notably, no member of the public provided a plausible explanation of public benefit from state HPTCs for owner-occupied residences. Owner-occupied residences are not eligible for federal HPTCs, and the 2014 HPTC Audit points out that state HPTCs to non-income-producing, single-family, owner-occupied residences do not provide an economic benefit to the public.³⁵¹ Nonetheless, the state HPTC program commits tax dollars to improve private historic residences.

³⁴³ See *Report on Missouri Tax Credits Administered by the Department of Economic Development* (February 2017) at 72 (the "2017 DED Tax Credit Report").

³⁴⁴ See *Report on Missouri Tax Credits Administered by the Department of Economic Development* (February 2017) at 72 (the "2017 DED Tax Credit Report").

³⁴⁵ Testimony of James Farrell at the Committee's Town Hall in Maryville (May 17, 2017).

³⁴⁶ See 2017 DED TAX CREDIT REPORT, *supra* note __,

³⁴⁷ See 2017 DED TAX CREDIT REPORT, *supra* note __,

³⁴⁸ See 2014 HPTC Audit at 18-19.

³⁴⁹ See Jennifer Weiner, *State Business Tax Incentives: Examining Evidence of their Effectiveness* (December 2009) at 1.

³⁵⁰ See 2014 HPTC Audit at 15.

³⁵¹ See 2014 HPTC Audit at 13; see also Report of the Missouri Tax Credit Review Commission (November 30, 2010) at 35 (the "2010 Commission Report") (recommending limits to HPTCs authorized for non-income-producing single family residences).

The state HPTC program is excessively large and provides an unjustifiably low direct economic benefit to Missouri's taxpayers. The Committee recommends the following statutory measures to ensure that Missourians get a fair return for their hard-earned tax dollars.

Recommendation: Consolidate the HPTC and Brownfield remediation tax credit into one Redevelopment Tax Credit program (the "RTC").

- HPTCs and Brownfield remediation tax credits are often stacked on individual redevelopment projects. Consolidating them into one program would make sure that taxpayers don't pay twice for the same development.

Recommendation: Subject the RTC to the overall Tax Credit Stability Fund authorization cap (discussed above).

- The current HPTC authorization cap is \$140 million per year, and there is no cap to the amount of Brownfield remediation tax credits authorized. Apart from the HPTC authorization cap, the State has no certainty as to how many credits will be authorized, issued, or redeemed in any given year. The Tax Credit Stability Fund would place a cap on the overall amount of tax credits authorized in a given year, and the RTC program would be subject to appropriations for the General Assembly to properly allocate resources based on the program's viability to the State.
- The appropriations process would pre-fund tax credits and make it clear how much is allocated to each program. This would simplify reporting and make it easier for taxpayers to see how the State is investing their tax dollars. Additionally, this would increase predictability of State revenues allocated to specific tax credit programs and would help mitigate unforeseen budget shortfalls due to excessive tax credit redemptions in a given year.

Recommendation: Institute a per-project cap of \$2 million to ensure equitable funding opportunities for RTC projects in large and small cities.

- Large projects in urban centers tend to use much higher amounts of HPTCs and Brownfield remediation tax credits than do modest-sized projects in rural areas of the State. A per-project cap would ensure that a handful of large RTC projects don't deplete the Tax Credit Stability Fund at the expense of projects that require only a fraction of the credits.

Recommendation: Institute a per-square footage value cap to prevent RTCs from subsidizing unnecessary expenses.

- Unnecessary expenditures that raise the value per square footage (e.g. marble counters, premium flooring) provide additional benefit to developers, but not to the public.

Recommendation: Include a 5-year sunset provision for the RTC program.

- A sunset provision would require the General Assembly to conduct an in-depth review of the RTC program and determine whether the program is achieving its intended purpose, and if not, how to address any shortcomings going in future years. A sunset provision has been widely recommended

in recent years, and there is no reason why the RTC program should be exempt from regular review.³⁵²

Recommendation: Exclude private residences from RTC eligibility.

- Private residences do not provide a public benefit and should not receive public funding.

Recommendation: Eliminate the HPTC carry-back period and shorten the HPTC carry-forward period to 3 years.

- These steps would make the credits' revenue impact on the State more predictable and stable, which would help mitigate unforeseen budget shortfalls due to excessive tax credit redemption.

F. Missouri Works Program

The Missouri Works Program ("Missouri Works") provides a mix of tax incentives for in-state and out-of-state businesses that create new jobs in Missouri. Upon achieving statutorily-set job creation, wage, and health insurance targets, Missouri Works applicants are entitled to retain the State withholding tax stemming from the new jobs for a period of five to six years. Applicants creating fewer than ten new jobs must also invest at least \$100,000 of new private capital in local facilities. There is no limit to the amount of withholding tax retention granted under Missouri Works.³⁵³

Missouri Works applicants may also be considered for discretionary tax credits awarded by DED. DED may issue up to \$116 million of discretionary Missouri Works tax credits per year, and no award may exceed the net State fiscal benefit from such project.³⁵⁴

Notably, Missouri Works benefits are not awarded until the applicant meets agreed-upon job creation, average wage, and health insurance goals.³⁵⁵

DED considers the following criteria to determine awards of discretionary Missouri Works tax credits:

- The least amount necessary to obtain the applicant's commitment;

³⁵² See 2014 HPTC Audit at 14-15; 2010 Commission Report at 10; Supplemental (and Minority) Report by Certain Members of the Missouri Tax Credit Review Commission (December 12, 2012) at 3.

³⁵³ See Missouri Department of Economic Development Missouri Works Program Summary, available at https://ded.mo.gov/sites/default/files/programs/flyers/MissouriWorksProgSum2016_0.pdf (the "Missouri Works Program Summary").

³⁵⁴ See Missouri Department of Economic Development Missouri Works Program Summary, available at https://ded.mo.gov/sites/default/files/programs/flyers/MissouriWorksProgSum2016_0.pdf (the "Missouri Works Program Summary").

³⁵⁵ See Missouri Department of Economic Development Missouri Works Program Summary, available at https://ded.mo.gov/sites/default/files/programs/flyers/MissouriWorksProgSum2016_0.pdf (the "Missouri Works Program Summary").

- The project's overall size (e.g. number of jobs, payroll, and new capital investment) and quality (e.g. average wages, growth potential, and industry type);
- The applicant's level of financial stability and creditworthiness;
- The level of economic distress within the project area;
- The competitiveness of alternative locations; and
- The amount of local incentives committed to the project.³⁵⁶

Since its inception in 2014, Missouri Works has become one of the State's largest tax credit programs, accounting for nearly \$115 million of authorized tax credits in FY 2016.³⁵⁷ Additionally, the State has authorized over \$244 million in withholding tax retention entitlements from FY 2015 through FY 2025, an average of about \$22.2 million per year.³⁵⁸

At the Committee's town hall meetings, Missourians suggested that Missouri Works is well worth the State's investment. Mayor Ken McClure of Springfield noted that Missouri Works has become his city's "number one tool" for business expansion, leading to major investment and new jobs from companies like 3M and O'Reilly Auto Parts.³⁵⁹ Backing up Mayor McClure's claims, 3M manager Frederick James noted that 3M's decision to expand its Springfield facility and add local jobs wouldn't have happened without Missouri Works incentives.³⁶⁰

The numbers corroborate the public's perception of Missouri Works. As calculated by DED, Missourians realized \$1.95 of direct economic benefit for each dollar of Missouri Works tax credits awarded in FY 2016, which led to the creation of 5,323 actual jobs.³⁶¹ Additionally, Missouri Works tax credits are not issued unless the recipient actually meets its job creation, wage, and health insurance targets - this safeguard protects the State from realizing a negative return.

Missouri Works has been successful thus far, resulting in a nearly 2:1 return to taxpayers in the form of actual jobs created. The Committee recommends the following statutory measures to enhance the program and make Missouri even more competitive for high-quality jobs.

Recommendation: Subject Missouri Works' withholding tax retention benefit to DED's discretionary approval, pursuant to the same guidelines applicable to the Missouri Works tax credits.

³⁵⁶ See Missouri Works Program Summary.

³⁵⁷ See DED 10 Year Tax Credit Report, received pursuant to the Committee's letter request.

³⁵⁸ See DED Missouri Works Withholding Tax Retention Report, received pursuant to the Committee's request.

³⁵⁹ Testimony of Mayor Ken McClure at the Committee's Town Hall in Springfield (June 7, 2017).

³⁶⁰ Testimony of Frederick James at the Committee's Town Hall in Springfield (June 7, 2017).

³⁶¹ See *Report on Missouri Tax Credits Administered by the Department of Economic Development* (February 2017) at 138.

- Currently, businesses can qualify for withholding tax retention regardless of whether such benefit affects their decision to locate to Missouri. As long as a Missouri Works applicant meets its job creation, wage, and health insurance goals, it is entitled to the benefit.
- Shifting the withholding tax retention benefit to a discretionary award would allow DED to properly allocate the benefit to companies who would not locate to or expand in Missouri without it.

Recommendation: Raise the cap for Missouri Works tax credits to \$160 million to make the State even more competitive.

- Unlike the State’s HPTC and LIHTC programs, the Missouri Works program has proven to be a positive investment for Missouri taxpayers, resulting in cost-effective job creation and direct economic benefit.
- Missouri Works tax credits contain safeguards to ensure that taxpayers realize a positive return on their investment, including a results-based issuance trigger, discretionary approval, and a per-project cap equal to the net State fiscal benefit from such project.

Recommendation: Update the Missouri Works Training Program to allow job training programs for new jobs, retained jobs, or any combination thereof.

- According to DED, it is administratively difficult to distinguish between training programs for new jobs and retained jobs, particularly as retained jobs evolve due to automation and technological advancement. A minor statutory amendment would make it simpler for DED to allocate the Missouri Works Job Development Fund to worthy training programs.³⁶²

G. Discretionary Closing Fund

Over twenty states³⁶³ have rounded out their economic incentive arsenals with a flexible “closing fund” to win high-return economic development projects.³⁶⁴ Closing funds are used as final incentives for projects that offer a high return on the State’s investment, ranging from business recruitment and workforce development to infrastructure projects and research funding. In many cases, closing funds are overseen by a group of state officials.³⁶⁵ The Texas Enterprise Fund, widely regarded as best-in-class, requires the approval

³⁶² Interview with Amy Sublett, Director of Division of Workforce Development, DED (June 13, 2017).

³⁶³ As of 2012, those states include: Oregon, Montana, Colorado, Arizona, New Mexico, Oklahoma, Texas, Arkansas, Louisiana, Mississippi, Florida, Georgia, South Carolina, North Carolina, Virginia, West Virginia, Pennsylvania, Delaware, New Jersey, and Maryland.

³⁶⁴ See Ben Weisfuse, *Sealing the Deal: Why States are Incorporating Deal Closing Funds into Economic Development Strategy*, SITE SELECTION MAGAZINE, May 2012 <http://siteselection.com/onlineInsider/sealing-the-deal.cfm>; see also *The Biggins, Lacy, Shapiro Co. 2016 State Incentives Resource Guide*, (last accessed May, 31, 2017) <http://www.blsstrategies.com/docs/pages/files/2016%20State%20Incentives%20Guide%206-2-16.pdf>.

³⁶⁵ See Ben Weisfuse, *Sealing the Deal: Why States are Incorporating Deal Closing Funds into Economic Development Strategy*, SITE SELECTION MAGAZINE, May 2012 <http://siteselection.com/onlineInsider/sealing-the-deal.cfm>; see also *The Biggins, Lacy, Shapiro Co. 2016 State Incentives Resource Guide*, (last accessed May, 31, 2017) <http://www.blsstrategies.com/docs/pages/files/2016%20State%20Incentives%20Guide%206-2-16.pdf>.

of multiple state officials for each disbursement of business recruitment incentive grants.³⁶⁶ In FY 2016-17, Texas's legislature appropriated \$90 million for the Texas Enterprise Fund, recognizing the fund's proven track record of success attracting Fortune 500 companies and funding critical research at state universities.³⁶⁷ Following Texas's lead, states such as Florida, Arkansas, Oklahoma, Ohio, and Michigan have adopted their own closing funds.

Recommendation: Missouri should create its own closing fund, the Missouri Jobs and Opportunity Fund (the "MOJO Fund"), to better compete with peer states for high-return economic development and infrastructure projects.

- The MOJO Fund would provide a flexible, direct incentive to close business development projects with high job-creation potential, as well as community development projects that can positively transform a region (e.g. large infrastructure projects and long-neglected school repairs).
- The Committee recommends allocating \$50 million per year to the MOJO Fund.
 - The MOJO Fund could be partially funded by the interest collected on the Tax Credit Stability Fund (discussed herein).
- To ensure the MOJO Fund's constitutionality, the Committee recommends that it operate through the following process:
 - First, the Missouri Department of Economic Development ("DED") would recommend award amounts/recipients to the Missouri Development Finance Board ("MDFB").
 - Second, MDFB would approve MOJO Fund incentives to recipients pursuant to DED's recommendations.
 - To be eligible for MOJO Fund incentives, projects would be required to achieve a statutorily defined "public purpose".
 - Additionally, the MOJO Fund should adhere to similar award approval guidelines as the Texas Enterprise Fund, which instituted several safeguards pursuant to a 2014 audit, including:
 - The project must obtain local incentives;
 - There must be an actual, active competition with another state for the same project;
 - The project must result in significant job creation, high-paying jobs, and significant economic benefit to the State; and

³⁶⁶ See Tex. Gov't Code § 481.078(h) (West 2017).

³⁶⁷ See *Spotlight: The Texas Enterprise Fund*, Texas Public Policy Foundation (accessed May 31, 2017).

- Each award should include clawback protections to ensure that State resources are only granted in exchange for results.³⁶⁸
- DED should be required to submit regular reports to the General Assembly detailing MOJO Fund investments and results (e.g. amount of funds committed, jobs pledged, and location of pledged investment).

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³⁶⁸ See *Texas Enterprise Fund - Eligibility* (accessed June 14, 2017), available at <https://texaswideopenforbusiness.com/services/texas-enterprise-fund>.

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APPENDIX I

RECOMMENDATIONS

CORPORATE INCOME TAX

1. **Eliminate Missouri's current corporate income tax and replace it with a broad based gross receipts tax.**

- Missouri's current corporate income tax structure is complex, high and slanted towards special interests who can afford lobbyists, accountants and tax lawyers to wade through the morass of statutes and regulations. A gross receipts replacement would even the playing field in a number of ways. It would reduce reducing tax planning opportunities. No longer would corporations be able to take on excessive amounts of debt in an attempt to decrease their state effective corporate income tax rate by taking interest payment deductions. A gross receipts tax has no deductions. Also, a gross receipts tax would end the apportionment method debate by requiring all entities to adopt the single factor sale tax method.
- Additionally, a gross receipts tax would simplify state tax compliance. Taxpayers would be able to complete their entire state income tax return on a postcard sized document. The post card sized document would contain one entry for total gross receipts in Missouri, and then ask the taxpayer to multiply that amount by 0.225% to end up with total income tax owed to the state.
- Moreover, all entities would be treated equally. No matter whether a taxpayer chooses to organize their business as a corporation, a partnership or a sole proprietorship, each of these entities would be subject to the same, low tax rate.
- The gross receipts tax could be phased in over three years. Within a year of the enactment of the tax reform package, the Department of Revenue would implement a system to handle the alterations to the corporate income tax. Then, beginning on January 1 of the year after implementation of the new system, the corporate tax rate would be reduced to 3.25% and gross receipts would be taxed at 0.1125%. The year after implementation, the corporate tax would be eliminated entirely and the gross receipts tax would rise to its full 0.225%.

2. **As the implementation and phase-in takes place, Missouri should also repeal the state corporate income tax deduction for federal corporate income taxes paid.**

INDIVIDUAL INCOME TAX

3. **Recommendation: Reform Individual Income Tax Rates to Make Them Simple, Fair and Low.**

- Missouri's individual income tax brackets are outdated and unnecessarily numerous. Therefore, the Committee recommends restructuring the individual income tax brackets and rates as follows:

\$0.00 – \$5,000 = 1%

\$5,001 – \$10,000 = 3%
\$10,001 – \$15,000 = 4%
\$15,001 – \$20,000 = 5%
Above \$20,000 = 5.5%

4. **Recommendation: Eliminate Missouri's Federal Income Tax Deduction.**

- The Committee's recommendations as a whole seek to make Missouri's tax structure simple, fair and low. In keeping with that policy, the Committee recommends that Missouri join its 44 sister states and repeal the state individual income tax deduction for federal income taxes paid. Furthermore, Missouri should also join every other state in the union and repeal the timely filing discount for withholding tax. Neither one of these tax loopholes provide a material competitive advantage to Missouri's economic climate. Closing the loopholes allows for an overall rate decrease and reduction of individual income tax brackets.

5. **Recommendation: Adopt a Working Family Tax Credit to Assist Missouri Families.**

- The Committee also recommends the General Assembly implement a workforce tax credit or childcare credit for working families. As Rod Chapel testified, a workforce credit would be based on income and target the economy as a whole, while a child care credit would be based on the number of children in a family. Ultimately, this decision will need to be made by the Missouri General Assembly. Either credit would spur the economy since these funds would mostly be spent in the local community.

6. **Recommendation: Individual Income Tax Reform Timing.**

- Since the above recommendations for individual income tax all work within the existing individual income tax structure and only involve a change of the rates, adoption of a pre-modeled tax credit system and the repeal of two tax loopholes, the individual income tax changes should become effective for all tax years beginning on or after January 1 of the first year after the statute is truly agreed to and finally passed by the General Assembly and signed by the Governor.

SALES TAX

7. **Recommendation: Simplify and Lower the State Sales Tax Rate.**

- The Committee recommends adopting one sales tax rate of 4%, by eliminating all exemptions, with two exceptions:
 - i. First, the sale of groceries would be taxed at 1% and that special sales tax rate would expire without legislative action after five years.
 - ii. Second, Business to business sales would be exempt from sales tax, if the sale was of a part used in directly creating a product that will ultimately be sold at retail. The committee acknowledges that the lack of exemptions and exclusions would compel some residents to cross state lines to purchase goods.

8. **Recommendation: Repeal the 2% vendor discount.**

- This is an outdated tax loophole in which the state provides a financial inducement for following the law. Missouri does not provide a cash rebate for driving under the speed limit and should not provide a benefit for the legally mandated collection of sales and use tax.

9. **Recommendation: Impose a Cap on Sales Tax Rates Throughout Missouri.**

- Missouri's many sales tax jurisdictions and rates are confusing, complicated, and regressive, and their growth over recent years should cause concern. A statutory sales tax cap could mirror Missouri's "Mack's Creek Law", which places a cap on the amount of revenue that municipalities can generate from traffic tickets.
- Mack's Creek Law requires that any traffic ticket revenue collected by a municipality over a statutorily-set percentage of the municipality's annual revenue be remitted to Missouri's general revenue, thus curbing municipalities' incentives to exploit traffic tickets as a disproportionate source of revenue.
- The Committee also recommends that the General Assembly introduce stability and certainty to the State's sales taxes by capping the overall sales tax rate at 12%, including any add-on sales taxes imposed by TIFs, TDDs, and CIDs.

10. **Recommendation: Adopt an Economic Nexus Standard to Collect Unpaid Sales Tax.**

- The Committee recommends adopting an economic nexus standard to capture this unpaid tax. The suggested requirements would be similar to South Dakota. It is recommended to enact legislation that requires sales tax be collected and remitted to the Missouri Department of Revenue, if an entity has annual sales exceeding \$100,000 or they have 200 separate transactions within the state.

11. **Recommendation: Missouri Should Join the Streamlined Sales Tax Agreement.**

- Admission to the group of states who have adopted this Agreement would ease Missouri's transition into collecting sales and use tax from remote sellers, should Congress pass the current iteration of the MFA.

FUEL TAX

12. **Recommendation: Missouri should adjust its fuel tax to match the rate of inflation and account for increasing fuel economy, enabling the State to fund critical infrastructure maintenance and improvement.**

- Missouri's current fuel tax is out of date with inflated maintenance and construction costs. To ensure that Missouri can become a best-in-class state to do business, the State must address its infrastructure funding shortfall.
- Following Georgia's successful model, Missouri's should tie its fuel tax rate to (1) consumer price index and (2) average fuel economy to ensure that the State is able to provide Missourians with high-quality roads and bridges for years to come.

TAX CREDITS (GENERAL REFORMS APPLICABLE TO ALL TAX CREDITS)

13. **Recommendation: Allow Denial of any Tax Credit Application that Fails to Meet a Public Purpose**

14. **Recommendation: Allow Denial of a Tax Credit Application if the Activity Would Occur Without State Incentives**
15. **Recommendation: For Economic Development Tax Credits, Allow Denial of Applications that Fail to Demonstrate a Positive Fiscal Return to the State**
16. **Recommendation: Allow DED to Deny Applications for Failure to Show Technical or Financial Ability to Perform**
17. **Recommendation: Annually Appropriate the Amount of Tax Credits for Each Program and Allow for Gubernatorial Withholding**
18. **Recommendation: Enact a General False Claims Act to Reign in Fraud, Waste, and Abuse**

TAX CREDIT STABILITY FUND

19. **Recommendation: The General Assembly should create a Tax Credit Stability Fund (“TCSF”) funded from a Gross Receipts Tax (discussed above) to pre-pay for new tax credit authorizations.**

LOW INCOME HOUSING TAX CREDITS

20. **Recommendation: Convert the state LIHTC program to a low- or no-interest loan program (the “LIH Loan Program”) for affordable housing construction, as demonstrated in Figure 2.3 in the Report.**
 - Switching to the LIH Loan Program would eliminate most of the inefficiencies of the current tax credit program, including federal tax consequences and third-party syndication fees. 100% of State LIH Loans would go toward housing construction, a vast improvement from the current LIHTC’s 42% efficacy.
 - MHDC has an AA+ bond rating and could effectively transition from issuing LIHTCs to LIH Loans.
21. **Recommendation: Repurchase outstanding LIHTCs through MHDC and exchange them for certificated credits with shorter redemption periods, saving the State 15-20% of its outstanding LIHTC liabilities in the process.**
 - Under a certificated tax credit model, MHDC would issue certificates that investors could purchase to reduce their Missouri tax liability. Unlike the current state LIHTCs, certificated tax credits could be transferred to persons outside of the ownership group, expanding the pool of potential investors.³⁶⁹ This would increase the credits’ marketability.
 - According to Stifel, for every dollar of outstanding LIHTCs repurchased, the State would save approximately 15-20% of its associated liability
22. **Recommendation: Subject the LIH Loan Program to the overall Tax Credit Stability Fund authorization cap.**

³⁶⁹ See 2014 LIHTC Audit at 14.

- The Tax Credit Stability Fund would place a cap on the overall amount of LIH Loans issued in a given year, and the LIH Loan Program would be subject to appropriation for the General Assembly to adjust the program's budget allocation as needed.
 - i. Affordable housing is important, but in a world of limited resources, the LIH Loan Program must be evaluated along with other critical budget needs like schools and mental health funding.

HISTORIC PRESERVATION TAX CREDITS

23. Recommendation: Consolidate the HPTC and Brownfield remediation tax credit into one Redevelopment Tax Credit program (the "RTC").

- HPTCs and Brownfield remediation tax credits are often stacked on individual redevelopment projects. Consolidating them into one program would make sure that taxpayers don't pay twice for the same development.

24. Recommendation: Subject the RTC to the overall Tax Credit Stability Fund authorization cap (discussed in the Report).

- The current HPTC authorization cap is \$140 million per year, and there is no cap to the amount of Brownfield remediation tax credits authorized. Apart from the HPTC authorization cap, the State has no certainty as to how many credits will be authorized, issued, or redeemed in any given year. The Tax Credit Stability Fund would place a cap on the overall amount of tax credits authorized in a given year, and the RTC program would be subject to appropriations for the General Assembly to properly allocate resources based on the program's viability to the State.
- The appropriations process would pre-fund tax credits and make it clear how much is allocated to each program. This would simplify reporting and make it easier for taxpayers to see how the State is investing their tax dollars. Additionally, this would increase predictability of State revenues allocated to specific tax credit programs and would help mitigate unforeseen budget shortfalls due to excessive tax credit redemptions in a given year.

25. Recommendation: Institute a per-project cap of \$2 million to ensure equitable funding opportunities for RTC projects in large and small cities.

- Large projects in urban centers tend to use much higher amounts of HPTCs and Brownfield remediation tax credits than do modest-sized projects in rural areas of the State. A per-project cap would ensure that a handful of large RTC projects don't deplete the Tax Credit Stability Fund at the expense of projects that require only a fraction of the credits.

26. Recommendation: Institute a per-square footage value cap to prevent RTCs from subsidizing unnecessary expenses.

- Unnecessary expenditures that raise the value per square footage (e.g. marble counters, premium flooring) provide additional benefit to developers, but not to the public.

27. Recommendation: Include a 5-year sunset provision for the RTC program.

- A sunset provision would require the General Assembly to conduct an in-depth review of the RTC program and determine whether the program is achieving its intended purpose, and if not, how to address any shortcomings going in future years. A sunset provision has been widely recommended in recent years, and there is no reason why the RTC program should be exempt from regular review.

28. **Recommendation: Exclude private residences from RTC eligibility.**

- Private residences do not provide a public benefit and should not receive public funding.

29. **Recommendation: Eliminate the HPTC carry-back period and shorten the HPTC carry-forward period to 3 years.**

- These steps would make the credits' revenue impact on the State more predictable and stable, which would help mitigate unforeseen budget shortfalls due to excessive tax credit redemption.

MISSOURI WORKS PROGRAM

30. **Recommendation: Subject Missouri Works' withholding tax retention benefit to DED's discretionary approval, pursuant to the same guidelines applicable to the Missouri Works tax credits.**

- Currently, businesses can qualify for withholding tax retention regardless of whether such benefit affects their decision to locate to Missouri. As long as a Missouri Works applicant meets its job creation, wage, and health insurance goals, it is entitled to the benefit.
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DISCRETIONARY CASH FUND

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